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The opinions expressed by the authors of articles appearing in this magazine are their own, and frequently are intended to stimulate further discussion on the subject. Publication of any material does not necessarily mean that the Society, its Board of Directors, or editors approve or agree with the opinions expressed by the authors. Readers are invited to submit their own comments or articles.

the **Illinois CPA**

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In the interest of adding a person-to-person touch to the AICPA internal public relations program last April, President Jack Seidman and Executive Director John Carey arranged a round table meeting at the AICPA offices in New York with fifteen "inactive" members of the Institute to discuss mutual professional problems. Messrs. Seidman and Carey were so impressed

with the results of this meeting as a means of bringing the Institute closer to many local practitioners that a release was issued to all Council Activity Chairmen urging them to set up similar meetings throughout the country. This, said the release, was a way of demonstrating the Institute's interest in the problems of the local practitioner and constituted a practical device for eliciting members' opinions of Institute services and publications. Louis Pilie, the current Institute president, has given his full support to the continuation of this program.

In response to these urgings, our Illinois Society Committee on Liaison with AICPA, composed of Illinois Council members, met last November to arrange for the first of a series of round table discussions. The date for the first meeting was set for December 9, 1960, from 3 to 5 P.M. Four Council members were designated to participate in this first meeting. I was one of them.

A list of over thirty "inactive" Institute members was prepared as the "field" for the first meeting. Only twelve of these were able to accept the invitation. I must confess,

President's MESSAGE

throughout these preliminaries I had vague misgivings about the reception that would be accorded this whole program.

At the appointed hour we convened in a private room at the Palmer House. We arranged ourselves around a hollow square formed by four large tables so that each man had a full view of the entire field. Each of the Council members made a few introductory remarks concerning some phase of Institute activity involving service to members and then the chairman threw the meeting open for discussion.

The questions and remarks were largely confined to the subjects of large firm versus small practitioner, banker relations, discriminatory practices in the engagement of auditors for enterprises seeking public financing, technical services to members, rules of professional conduct, referrals and consultations among members.

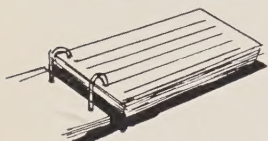
The discussions were lively, interesting, well-reasoned and revealing. Midway through the meeting I began to take stock of the individuals who had responded to the invitation. These persons were not only members of the Institute, but each was also a member of the Illinois Society. These men had been members of the Society for periods ranging from 8 to 28 years, yet, despite my more than 15 years of activity in the Society, I knew only one of the members personally. This, to me, was something of a jolt. Where did they keep themselves?

The "guests" included sole practitioners and partners in local firms. Some of these firms were not inconsiderable in size. One of the men was a member of a five-man partnership with a substantial staff. As I listened to the participants express themselves on the topics at issue, I took new pride in our profession. These people, picked, you might say, at random, were intelligent, articulate, personable, alert, and of good humor.

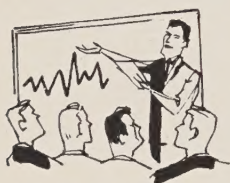
The greatest compliment that could possibly have been paid to the whole idea was succinctly put when a number of those present suggested that the "same bunch" ought to get together for another meeting. Unfortunately an early repeat is not feasible since the objective of the program at this time calls for rotation. But if you should be invited to a future meeting, drop whatever you are doing and go.



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Challenge of the Future: Can the Profession Meet the Expanded Demands of Business Management?

Professional Accountancy At the Crossroads

By William A. Campfield

The public accounting profession after a very extraordinary development during the past half century appears to have reached crossroads faced with a choice between two significantly different courses of future action.

On the one hand, members of the profession could join the forces, both internal and external to the profession, that clamor for more rules, dicta, and mechanical guides governing the practice of accountancy. These forces, in general, would limit the ambit of accountants to a sophisticated expression of historical accounting and business statistics according to the concept of the day regarding "business usefulness."

Following the other main course of future action, members of the accounting profession could choose to reshape materially the primary mission of the profession in a way to place major emphasis on assisting and advising business managements with respect to profit planning and in-progress evaluation of operations.

The writer believes that choice by the profession of the second pathway leading from the crossroads will assure a longer lived and more intellectually stimulating future for professional accountants.¹ Implicit in this proposed course of action is the urgent need for accountants to prepare through improved technology and broader gauged thinking to assume the leadership in economic statesmanship to which their science and their glorious heritage entitles them.

The balance of this paper is devoted to discussion of specific areas for emphasis in reshaping the image and the future of professional accountants. A preliminary observation is relevant. A close analysis of the major historical developments in accountancy will show that the activities of independent accountants and auditors, especially certified public accountants, are those referred to most often when professional accounting is mentioned. Since the independent

¹ The views expressed are the author's and do not express an official position of any organization with which he is associated.

accountant or auditor most nearly represents the profession as a whole, the remaining discussion uses him as prototype.

Re-Defining the Profession's Major Objectives

The most immediate major problem facing the designers of the future of accountancy appears to be that of close evaluation of the profession's objectives and long range goals. A fruitful approach to this re-evaluation would start with a premise that the long range goals should be set at the highest level of business and economic counsel and leadership reasonably attained by accountants. This means viewing the role and ambit of accountants as embracing far more than mere expression of opinions on financial statements, conventional accounting systems work, and preparations in respect to tax matters of individual business enterprises.

In brief, the writer suggests that the professional accounting approach should be re-defined and reshaped to approximate that followed by top management of business enterprises, i.e., thinking of every major facet of an enterprise (planning, scheduling, controlling, evaluating, etc.) in terms of its effect on the totality or unity of enterprise goals and objectives. In this frame of reference, the major goals and responsibilities of accountants can be redesigned so as ultimately to bring the accountant actively into the arena of pre-decision idea exchange with the top hierarchy of an enterprise.

A logical starting point for broadening the management value of the accountant's services is in the area of improving the evaluative and interpretative aspects of accounting and

reporting systems. It is well known in management circles that the art of accounting is deficient in that data are typically presented to management *ex post facto* and generally only in terms of over-all enterprise accomplishments rather than in terms of accomplishments by organizational segments and organizational responsibilities. Many of the conventional accounting records and reports suffer from lack of focus. They fit all purposes poorly and no one purpose too well.

In the circumstances, professional accounting emphasis could well be redirected toward active assistance of a management in ascertaining needed changes in accounting and reporting systems so that they more nearly serve management's requirements for fixing responsibility for results and measuring the effectiveness with which management's programs are carried out. Further, a renewed emphasis is needed in aiding a management to obtain timely data. Accounting data and reports should remind management of the consequences of prior decisions. Obviously, relevant information must be presented promptly to all responsible persons in the management hierarchy if they are to obtain maximum usefulness from accounting data in the decision making and evaluation process. An additional point is pertinent. Increased efforts by accountants are needed in helping to refine accounting controls in terms of measuring and comparing planned operations with actual operations. This doubtless will require accountants to assist management in establishing standards, cost and other wise, that are agreed upon by management and workers as fair and attainable levels of performance.

Variance analyses are not likely to have long run meaning to management unless they are established in a setting of agreed upon standards.

The next higher tier of expanded accounting scope and service is the examination and evaluation of non-accounting controls and operations. Work in this area by accountants should be a natural consequence of increased effort by them in respect to responsibility accounting. The operations control area is validly within the purview of the accountant since every operating activity has financial implications and all results of operations are expressed in accounting or accounting type records and reports. In his operational examination, the accountant should be concerned with such items as: (i) consistency of various management policies, programs, and procedures, (ii) their adequacy as points of reference for individuals with assigned responsibilities, (iii) compliance of organizational units with prescribed policies, programs, projects, and procedures, and (iv) opportunities for expanding the effectiveness of management controls to operating areas not yet subjected to controls.

The pinnacle of revised goals for professional accountants should be fixed in the area of counselling and aiding a management in the broad policy and long range planning sphere. It is submitted that service by the accountant in this area will bring him into close touch with the very heart of the management process. Three specific sub-areas in which advanced accounting knowledge and

expertise can be invaluable to a management are:

- (i) Synthesizing accounting, economic, and other statistical data which a management finds useful in constructing the basic policy and mission framework of the enterprise. For example, the accountant could systematically develop data regarding prospective demand in the industry as a whole, itemize factors affecting key supply sources, chart trends in competitive conditions within the industry, and prepare pro forma estimates of the relative standing of the enterprise with respect to share of markets, cost position, and competitive strength.
- (ii) Counselling and aiding management in establishing an orderly system for allocating responsibility for long range planning, progress review of plans-in-action, and post action evaluation of the effectiveness of plans.
- (iii) Assistance to management in improving the actual decision making process. To illustrate, the accountant could help to speed up decision making by reviewing or supervising the review of each of the major alternative plans prior to submission to top management for final decision. The accountant's review could be pointed to identifying those plans or strategies that conform most nearly to management's predetermined criteria for acceptable plans. If the accountant has worked closely enough to top management to gain useful knowledge of management's scale of preferences, he could make a preliminary arrangement of alternative plans in terms of this scale.

Before passing on to other matters, it is useful to suggest that unless the accounting profession gives early and careful attention to re-evaluating its long range goals and objectives it may find itself in the position of being comprised of skilled statistical technicians but representing a group of

WILLIAM A. CAMPFIELD, CPA, is presently associated with the San Francisco office of Army Audit Agency. The author of numerous articles, Dr. Campfield holds a Ph.D. degree in accountancy from the University of Illinois.

second class counsellors to business managements.

Broader Education and Experience Qualifications

Consonant with ideas expressed in the preceding section, the writer believes it imperative that leaders of the accounting profession take early and concrete steps to raise substantially the educational and experience qualifications requisite to designation as professional accountant. Obviously, this should be achieved over a span of years through a well conceived, orderly plan rather than by abrupt, piecemeal measures.

First, it seems essential that the minimum educational requirements be established high enough to be compatible with the requirements for entrance into other learned professions. Quantitatively, this should entail requiring that the professional accountant possess at least an undergraduate degree, with a major in accountancy. Qualitatively, there should be a co-ordinated effort on the part of accounting practitioners and educators to broaden the scope of academic training for accountancy. For example, it is believed desirable and necessary that the curriculum should be sufficiently well rounded that the graduate has been prepared to understand and use the technical factors of his field of concentration intelligently and constructively in relation to business, government, and society as a whole. Consequently, a greater emphasis is needed in integrating study of several of the social disciplines, e.g., economics, history, political science, law, etc., with the study of accountancy.

Business life is lived as a large unit rather than as compartmentalized

units of sales, production, accounting, etc. Accordingly, an academic program designed to inculcate in the prospective accountant an integrated, comprehensive view of economic, political, and social life as it is actually lived should significantly improve his capacity to think and act in terms of the totality of problems facing the business managements he will offer to serve.

A change in minimum experience qualifications and methods of licensure is a desirable corollary to revision of educational requirements. The writer believes that one year of creditable experience in any responsible supervisory accounting position, minimum education as indicated above, and satisfactory completion of a licensure examination (comparable to the present CPA examination) are sufficient to entitle the applicant to "enter the profession." Beyond this minimal entry requirement, the accounting profession might well establish specialty requirements comparable to the medical profession. Additional educational and experience requirements could be prescribed to qualify the general practitioner in areas such as management systems and controls, budgeting, taxes, economic and market analysis, compensation and pension plans, etc.

Before concluding this section it is well to reiterate that the long range future of professional accounting could well be assured through timely and intensified emphasis on orderly programs for training and developing accountants to deal more closely with matters of planning and control that are key aspects of the management process. Accounting and statistical data furnish a large part of the basic information needed by management

for plans and decisions. The professional accountant should so plan and accomplish his increase of knowledge and competence that managements will gladly accept him and his services as an adjunctive ingredient of major decision making.

Extending the Professional Image Through Public Service

In recent years there has been an accelerated tendency for many elements of society to challenge the professional man to assume more actively his inescapable duty of broad social responsibility. In this regard, the image of the professional accountant is shadowy, indeed, when compared to other learned professions, e.g., law and medicine.

There is a fairly widely held belief among the public that accountants are skilled only in the art of "checking books and accounts." Invariably, when the public is faced with broad social and economic problems at local or national level the services of professional men other than accountants are sought.

No one field of professional endeavor other than professional accounting requires of its practitioners such a varied and fundamental knowledge of the economic and legal factors affecting business enterprises and business transactions. Business enterprise admittedly is but one agency of society but it is patently a most important one in advancing the well being of the social order as a whole.

In the circumstances, the writer believes that the enlightened self interest of accountants can be served through judicious publicity regarding their willingness and availability to participate more widely in community

and public affairs. Of course, this publicity should be handled in a way that befits the dignity of a profession. Preferably, the national associations and related local societies of accountants should coordinate and direct such programs.

The best publicity for the profession is probably accomplished through direct, constructive service to the community by individual accountants. Numerous examples of areas for services can be cited. To illustrate, an accountant could render valuable managerial service as member or official of city councils, school boards, hospital, church, or other institutional boards or commissions; or, he could render specific accounting or financial services of greater depth on an "out of pocket" cost basis.

On a broader scale, accountants should be encouraged and facilitated by their professional associations to participate more actively in shaping policy over a wide range of public affairs. A few illustrations in this regard will suffice. Service as arbitrators in labor-management disputes is well within the competence of professional accountants since many of the issues in dispute are susceptible to the dispassionate quantitative measurement and evaluation traditionally associated with independent accountants. Assistance and counsel to governmental agencies and groups in respect to improving cost control and financial management of public affairs is another area of service that could be explored vigorously by professional accountants. A final illustration points up the desirability of accountants serving in direct management capacities in public affairs. Accountants should be willing to serve for such periods of time as will

be necessary to put the management of public offices on sound fiscal basis.

In this age of image projection by many pretenders to the throne of economic and social leadership, it behooves the accounting profession in its long run best interests to put forth the extra effort of advising and encouraging members to serve in public office, and otherwise assist as desirable in shaping public policy, developing good public administration, and contributing in general to the betterment of the entire community in which accountants work and live.

Summary

Mid-20th century has been characterized by sudden, rapid, and oft times violent change in economic, political, and social ideas. Much of this change had its genesis in the revolutionary scientific and technological developments since the early 1940s.

The nature and objectives of business management have undergone a parallel revolution over a wide range of plans, methodology, techniques, and attitudes. Professional accounting, traditionally an indispensable service adjunct to management control and evaluation, has in the estimation of the writer lagged behind in the age of innovation and change.

This paper presents three areas for emphasis by leaders of the accounting

profession in plotting the long range survival and growth needs of the profession. They are: (i) Re-definition of the profession's major objectives, (ii) broadening the educational and experience qualifications, and (iii) expanding the public service participation of accountants.

Change is the most pervasive reality of our times. If accountants persist in maintaining the status quo of traditional services they will surely be inviting disaster. For example, there are many less trained persons, fortified with the "miracle machines" of today, who are willing and able to offer managements statistical and reporting accuracy and reliability at less cost and in shorter time than would be available through conventional independent accounting certification.

Justice Oliver Wendell Holmes once remarked that a person who desired to live without trouble would have to die young. Further, he asserted that trouble creates a capacity to handle it. He concluded that an individual should not seek trouble but once encountered it should be met as a friend, accepted with faith, and the needful accomplished.

Professional accountants would do well to adopt the philosophy of Justice Holmes in dealing with the problems of change occasioned by the modern management revolution.

What Do You Have and What's to Become Of It?

By Samuel A. Sakol

Some time ago I encountered an ancient illustration of Estate Planning which, though rarely applicable in today's society, may be of interest to you. It involved a wealthy farmer who had 15 children by his deceased first wife, and 15 children by his still very much alive, second wife. She discussed with him one day the fact that he was getting quite old and that he ought to determine which child should be his heir. Her suggestion was that she arrange their 30 children in a row and that, counting from the first one, he then eliminate every tenth child; the last child to remain would be the one who inherited his estate. The farmer was impressed with the reasonableness of the plan and highly pleased with his wife's objective attitude.

As the elimination proceeded, the farmer became increasingly amazed to see that the first 14 children to be eliminated were all by his first wife and that the next to go would be the last member of that group. He suggested they start from that child and count backwards in the remaining elimination of every tenth child. Not

wishing to reveal that she had relied on anything other than chance, and knowing that the odds were 15 to 1 in her favor, the wife consented. With great chagrin she watched all 15 of her children successively eliminated and what had been the last remaining child of the first wife, became the sole heir.

If families of such size still existed, I would furnish you the mathematical formula under which the wife could make an arrangement with predetermined results. As it is I submit it as the earliest case of Estate Planning—of special interest, perhaps, because no provision for taxes was necessary, no battery of experts required and of further interest, perhaps as evidence that flexibility is of major importance in an Estate Plan.

Need for Estate Planning in a Changed Society

We have long ceased to live in a purely land economy. Our industrialization has produced not only a wide diversity on the forms by which capital is represented, but has been attended by an increasing distribution

in the ownership thereof. Forms of property, all of which may be completely appropriate for the prospective testator, may have a variety of degrees of propriety for his potential successors. We have also long ceased to live in a modestly taxed economy. The tax structure of our time is distinguished not alone for the heights which it is reaching but for the fact that the incidence of tax is determined as much by "how you do it" as by "what you do." Accepting the privileges of permitted discretions is among one's obligations to his family. As a result both of the nature of our economy and the level of taxes, the questions: What do you have, and what's to become of it? should no longer be restricted to the members of the 400 (if there are still 400 remaining).

And yet with the capital and earning capacity of any estate exposed to potential shrinkages from transfer (through taxes and costs), from liquidation (through forced sales and dispositions) and from management (through splitting up holdings and inexperience), it is regrettable that more advance planning is not done. Contributing to this neglect are the exaggerated concepts of privacy of financial matters, ignorance of the benefits of effective planning, and procrastination. Not entirely free from negligence are we who too frequently fail even to raise the question, either through preoccupation with other matters or because we feel compelled to have our clients make the overture.

Who Should Do the Planning

Far too frequently over-emphasis is given the question of who should initiate or direct the Estate Planning

function. It would appear that one who has been sufficiently capable or fortunate to accumulate that for which planning is needed, can be relied on to be equally capable or fortunate in selecting his closest adviser. Why should we become exercised over whether he is a trust officer, a CLU, a JD or a CPA? Just so it is not someone who holds merely the degree BS—which, in the presence of ladies, can be translated as meaning Bachelor of Superficiality.

Ours is the responsibility of changing the attitudes of many of our contemporaries. Those who are not lawyers must get over the notion that the attorney's contribution is supplying standard "boiler plate"; those who aren't CPA's must get rid of the attitude that the CPA handles the "arithmetic of the situation"; those who are not insurance counsellors must be relieved of the stereotype of the "peddler"; those who are not trust officers must give up the image of the corporate trustee as an "administrative clerk." "Boiler plate"; "arithmetic," "peddler," "clerk,"—all terms I'm sure you've heard applied and I trust you never use. But something more is required of us. Within our respective groups we must not permit them to be used with impunity.

Planning Must Originate in a Factual Determination

Whoever, in a given situation, is in the closest, most confidential relationship with the individual should suggest the need for Estate Planning. Sometimes it will be the banker, sometimes the attorney or financial or insurance counsellor, at other times the certified public accountant. Who initiates it is unimportant, since one

worthy of being relied upon, will suggest such other skills as are required by the circumstances. And it is an extremely simple situation which cannot benefit from the combined skills of all. The self discipline which distinguishes a professional man requires not only integrity and competence in the performance of his work, but humility and self restraint in what he undertakes to do.

It has been my belief that the essence of Estate Planning can be summed up as the answers to two questions: What do you have? and What's to become of it? All else is collateral and subject to greatly varying degrees of significance. Even the tax burden should be a secondary factor, although few individuals would qualify as the patient in the scene in which a dignified psychiatrist opens his examination by asking "When did you first begin to enjoy paying taxes?" If it is correct that Estate Planning is essentially the answer to the two questions: What do you have? and What's to become of it? then what is important is that the planning originate in a factual determination. If this sounds too elementary to require stating, ask any attorney how frequently he is requested to draw a will (under which property is to be distributed), without being furnished adequate information, and sometimes any information, on what there is to distribute.

Had I ever had any doubts about the dependence of sound planning on an enumeration and evaluation of actual holdings, they would have been dispelled in an examination, sometime

ago, of a draft of a proposed will. It was a document of excellent draftsmanship. Among other things, it created two trusts. The first was to be the pillar of security for the widow; she would enjoy not only its income but have unrestricted power to invade its principal; from the second trust she would receive income, but regardless of future need, would have no access to principal. The nature and extent of the property holdings were not made known to the attorney who prepared the proposed will. How could he know that applying the terms of the will to the property then owned, nothing whatever would go into the first trust?

Nature of Data Required

There is more than arithmetic involved in an enumeration and evaluation of all holdings and obligations. It must recognize the distinction between various types of property and give consideration to the income attributable to each. There must be adequate familiarity with respect to family relationships and the financial position of the parties in interest. Current income levels and tax brackets and accumulated gift tax record must be known. Special provisions or agreements such as in insurance, business interests and the like must be determined. The needs and objectives of the individuals must be made clear.

Frequently the CPA will already have much of the basic data, accumulated by him in connection with his auditing of the family business, his preparation of personal income and gift tax returns and other recurring

SAMUEL A. SAKOL is a partner in the firm of David Himmelblau & Co., Chicago, Illinois. This article is adapted from an address presented to the Chicago Council of Life Underwriters and Corporate Trustees in May, 1960.

engagements. He may have factual data on the form in which property is held and the existence of restrictive agreements, about which the owner himself has but a general, and frequently confused, impression. He may have necessary information on the manner in which property was acquired and its tax cost basis. His files may also contain pertinent financial data for related members of the family. But whether the situation is one requiring merely the supplementing of available data or the initial accumulation thereof, it is vital that adequate factual data be compiled. Whoever is primarily responsible for the planning must accept nothing less. The assembled inventory of all holdings, obligations and other pertinent data may then be analyzed.

Sometimes the most important data may be totally outside the area of property holdings. Consider the case of an individual who had spent a period of about 10 years making gifts to his wife and children as part of his own estate planning. Upon the death of his father, he inherited one-half of the estate, cancelling most of the benefit of his years of making gifts. He would have much preferred being passed over and having his interest go to his children. The attorney who represented the father knew nothing of the son's financial affairs. Neither did he know that leaving the daughter's share in trust for her children did not fit the needs or desires of that branch of the family. Due to the instability of her children, the daughter's situation would have been better served if she were the direct beneficiary. The father did not subscribe to the philosophy of exploring the preferences of one's heirs and

no one adequately impressed upon him, its importance. The CPA who was intimately involved in both the son's and daughter's financial affairs, could, if permitted, have helped to avoid the unfortunate results.

Analysis and Valuation

Whether the property is predominately listed securities, real estate, insurance or an interest in a business, necessarily fixes many of the problems as well as the solutions. Frequently the CPA can be helpful in the analysis and in determining valuations. This is particularly so in matters involving a business interest, since he is most aware of the limitations of financial statements.

The valuation of a business interest is not a mere academic question at the planning stage. It is not something which becomes a problem only after death and only for the purpose of tax liability determination.

Nor do changes in business conditions or the inevitable presence of the element of bargaining in tax valuations of a business interest, lessen the need for or preclude the effective use of a present valuation. The business interest will frequently represent a major part of the individual's holdings. The valuation thereof will to a large extent determine the answer to "what do you have."

Superficial valuation of a business interest may result not merely in inadequate or excessive provision with respect thereto. What is far more critical, it may result in not planning whatever. A substantial undervaluation may make the problem seem too minor to require serious planning; a substantial overvaluation may make it appear that adequate provision is so far beyond reach, that nothing will

be done. The problem of valuation, therefore, merits the greatest attention in considering a business interest in Estate Planning.

Don't labor under the illusion that knowing how to read financial statements and obtaining a certified balance sheet and a five year earnings summary leads you automatically to a valuation of a business. In March of this year the tax court had before it the valuation of a closely held corporation in the estate of one of the DuPonts (Paulina DuPont Dean—TC Memo Dec. 24, 104). Book value was \$43.58 per share; reported valuation in estate tax return was \$425. Internal Revenue Service determined a value of \$884.17; three expert witnesses for taxpayer testified to valuations of \$387, \$400 and \$462 respectively; expert witness for government testified to a valuation of \$700. I should like to quote from the court's opinion:

"We are convinced from the evidence presented by both sides that the respondent's determination of a value of \$884.17 per share is excessive. We are similarly convinced that the value per share of \$425 used by petitioner's in their return is inadequate. Beyond this, we are at one with Justice Cardozo who, in commenting upon his early years on the bench, once stated that he was much troubled in spirit to find how trackless was the ocean on which he had embarked."

But values, though fluid, need not be a trackless ocean. It is important to recognize that no standard, unvarying yardsticks exist. As another court (36BTA698) once put it—"the problem . . . must be solved by the exercise of sound judgment through the application of a method which is fair and proper under the facts and circumstances as they may appear in each particular case. . . ." The purpose to be served does not require one

to be an expert in each type of business encountered, nor necessarily a specialist in financial statements. As a matter of fact a wholesome skepticism about financial statements can go a long way toward keeping you out of trouble.

Balance Sheet Limitations

Accomplishing a meeting of minds through the use of the written word is a difficult problem even in the seemingly exact language of accountancy. When the CPA certifies that in his opinion "the accompanying balance sheet presents fairly the financial position of the company" the words used can well give the erroneous impression of a representation as to value. And yet the CPA intends to convey no such connotation. This is even more true since the innocuous title "Balance Sheet" has come to be replaced by what is considered the more meaningful title "Statement of Financial Condition." To begin with the CPA would like any reader to understand that the Balance Sheet is not an exact mathematical conclusion; that it necessarily reflects in varying measure the elements of judgment, approximations and estimates.

An even greater danger, for our present purposes, stems from the interchangeability of the words "worth" and "value" in their common usage. When the CPA uses the term "net worth" in the balance sheet, he would like the reader to know that it need have no relationship to the "value" of the company; that the capital and liabilities represent the funds made available by owners and creditors and that the assets reflect the property acquired with such funds. If the last-in, first-out method is used for inventories, they may be

stated at the price level existing some years ago, which may be only a fraction of current price levels; plant and equipment reflect costs prevailing when they were acquired and not current value thereof; if a pension or retirement plan is in effect, a substantial obligation of varying degrees of certainty may exist with respect to past service liability. Useful as the balance sheet is as a statement of accountabilities, it may be of no account as a criterion of current actual value.

Income Statement Limitations

Similar appreciation is necessary of the fact that the income statement is an historical summary of operation transactions which have occurred during a stated period of time. It deals only with what happened in the past. The indicated earnings may reflect inventory price fluctuations as well as operating results; charges for depreciation will vary with whether the properties were acquired during periods of high or low cost and with whether or not accelerated methods of depreciation are being used; in an unincorporated business, no compensation for owner's services may have been provided for; unusual or non-recurring transactions may be reflected therein. Useful as the income statement is as a measure of what transactions took place, it may not be a criterion of earning capacity.

The necessary perspective, then, is that the financial statements are tools to be used in determining value, rather than being determinative thereof. The price at which a willing buyer would buy and a willing seller would sell, both having knowledge of all the facts, can be approached only in terms of considering many relevant

factors and inquiring into the peculiarities of each individual situation. The CPA is in the best position to be aware of or to assemble a series of illustrations; let me just briefly touch on two.

An Example: Book Value Excessive

The company had outstanding a single issue of 2,000 shares common stock of which the interested individual owned one-third. The stock had a par value of \$100. At the pertinent date the net worth of the company was \$1,120 per share. The nature of the assets was such that the current ratio was about two to one, the working capital was \$595 per share and machinery, equipment and all other net assets were \$525 per share.

During the five year period preceding the valuation date, annual earnings per share had averaged just under \$100 and annual dividends paid had averaged \$60 per share. Based on then existing investment conditions and the above record, the \$1,120 book value could have been construed to be a reasonably fair measure of the actual value of the stock.

Collateral inquiry, however, showed that the business was of the "feast or famine" variety. Its typical cycle was made up of extremely profitable years and heavy loss years. The five year period under consideration did not encompass a full cycle. Expanding the period to ten years resulted in average annual earnings of \$80 per share instead of \$100 and average annual dividends of \$36 instead of \$60 per share. But even more important than the operating cycle, was an observation which showed that the recorded income was an improper measure of earning capacity. For purely

personal reasons, having nothing to do with the business operation, two officials were drawing only nominal compensation. The aggregate of all officers' salaries was under \$50,000 per year in this complicated manufacturing and selling organization having a volume in excess of \$5,000,000. By any objective standards, for the services required and received by the company, its officers' salary cost would have been at least \$50,000 greater than that reflected in its earnings. This was equivalent to \$25 per share. Effective earning capacity, therefore, was \$55 per share (on a ten year average basis) and not \$80 per share. On a five year basis, it was \$75 per share and not \$100. Compared with a book net worth of \$1,120 per share, a valuation of \$700 per share was determined.

An Example: Book Value Understated

Recently a valuation matter arose not from an estate planning problem but from a shareholder's desire to dispose of his interest. The company had a complicated capital structure which would make a discussion in terms of total value of the minority interest less confusing than one in terms of value per share of each class of stock. The buyer's representative computed average earnings, applied a multiplier and generously offered the shareholder \$260,000 for his interest. Book value of the interest was \$375,000.

Analysis revealed among other things that:

- (1) Inventories were in part carried at Lifo with the result that they were shown in the balance sheet at \$450,000 less than current costs.

- (2) The reserve for doubtful accounts was excessive by a minimum of \$125,000.
- (3) A new building had been constructed to replace one which had been taken over by a government unit in a condemnation proceeding. As a result of the exercise of the involuntary conversion provisions of the Internal Revenue Code, the new building was carried on the books at \$80,000 below actual construction cost.
- (4) Recently purchased goodwill of \$75,000 had been written off against retained earnings.
- (5) Accelerated depreciation had been taken on all fixed asset acquisitions subsequent to 1953.
- (6) In addition to the affect on earnings of the inventory, excessive bad debt reserve and depreciation elements previously mentioned, reported earnings were also affected by the facts that—
- (7) Within one year, officers' salaries for the identical group of people had jumped from a total of \$100,000 per year to a total of \$200,000 per year.
- (8) Within a five year period, \$250,000 had actually been contributed by the corporation to a private charitable foundation.

After adjusting asset values and earnings for these and other factors and consideration of comparable companies for which quoted market prices were available, a fair value of \$750,000 was determined for the interest for which \$260,000 had been offered. This price has not yet been obtained but negotiations are now on much more realistic basis.

Relevant Valuation Factors in Business Interests

Many other relevant valuation factors in business interests could be illustrated, and the following are only indicative of some of the considerations facing the CPA in the valuation of a business interest:

- Asset Values, adjusted for significant peculiar factors
- Earnings record, adjusted for significant peculiar factors
- Nature of business and relative risks therein
- Must the business be liquidated or can it continue
- Future prospects
- Marketability
- Price of comparable listed companies
- Condition of investment market generally
- Discount possibly attributable to minority holding
- Premium possibly applicable to majority holding.

Disposition of Business Interests

Disposition of business interests also presents many peculiarities not common to other holdings which may make up the contents of a prospective estate. Whether it is the entire or only a partial interest in a business, or whether it will automatically terminate at death or be legally undisturbed, its disposition poses many problems not akin to those inherent in securities, real estate, insurance or other assets. The absence of a ready market may mean an inability to retain part of such an interest and dispose of part of it, in order to satisfy debts and other cash needs. It may mean an inability to dispose of even all of the interest except under adverse conditions. If from a financial standpoint there is no need for liquidating, the business interest still presents problems in the requirement of active management rather

than the passive management required by other types of holdings. It involves highly personal and frequently emotional rather than rational considerations. The uncertainty of how soon the gifted son will level off, the pride in the family business, the question of future amicable relationships among survivors—these are but a few of the conflicts which must be resolved. Clearly such matters are personal and individual and lend themselves to no formal treatment. With equal clarity, however, they accentuate the need for planning what's to become of it. Here too the CPA's objective experience with the people involved ought not go unused.

If the business is to be liquidated, the objective of planning must be to permit an orderly liquidation, over an extended period, if necessary. If the business is to continue and the estate or beneficiaries of the decedent will retain their interest, there must be sufficient funds for taxes and other needs to carry out the objective.

More frequently, however, the situation is one in which it is desired that the business continue but that the decedent's interest therein be disposed of. Among the questions which then arise are: Should it be the other stockholders or partners who acquire the decedent's interest or the company itself? Should the obligation to sell be optional or compulsory? Should the obligation to buy be optional or compulsory? If the obligation to buy is compulsory, is there sufficient assurance of ability to buy to make the obligation meaningful? Should there be stipulated price, a formula, or should price be open?

Even the provision as to the date of valuation can be a factor of tremendous importance. Consider the

purchase agreement under which a corporation was to buy the holdings upon the death of either of its stockholders; the price was to be book value at a date three months subsequent to the date of death of either stockholder. One stockholder made the mistake of dying on February 10. Under the agreement, book value was thus to be determined as of May 10. The business was a highly seasonal one and almost totally inactive during the first four months of the year. It did no work, had no income but merely incurred heavy administrative and other overhead costs until the work season began late in the spring. As a result, although the book value per share had been \$350 at the preceding year end and would probably be about \$400 per share at the next year end, it was less than \$200 per share as of May 10.

Testing Alternative Arrangements

In some cases a desirable estate plan may be apparent to those participating in the work, immediately, upon analysis of the facts. In many it will be necessary to test alternative arrangements, to project the effect thereof (tax and otherwise) and to consider the prospective results in the light of the specific case. For example, there has been somewhat of a trend in the direction of having the closely held corporation recapitalized into preferred and common stocks in place of only common. Sometimes the object is to reduce the value of common to permit its sale to employees or its use in making gifts. In other cases it seeks to put the stock in such form as to permit the preferred to be retained by the heirs and the common to be disposed of to the active management.

Like many other generalizations this frequently does not fit. For example, I recently saw several situations in which it was proposed and would have been undesirable. In one the value of the company would be predicated entirely on earnings. The remaining value of the common would be apt to be but little reduced by the issuance of a preferred stock dividend. In another case the resulting fixed capital would be far in excess of the normal needs of the business. In still another there was considerable question as to whether normal earning level would be sufficient to cover the dividend requirement on the preferred issue under consideration.

In any event, planning must not restrict itself to consideration only of conditions after the death of the testator; it should concern itself also with the most effective holding of property during his lifetime; with the adequacy of insurance; with the part which might be played by profit sharing or pension plans, key man coverage, deferred compensation and other means of conservation.

Current Gifts

If current gifts are to be part of the plan, consider the cost of the property to be subject of the gift. Avoid, if possible, using property which has appreciated substantially in value, particularly if the donor is well along in years. This is still true even though the donee may now add to the cost basis of the property an allocable portion of the gift tax paid by the donor. This is an extreme illustration, but nevertheless an actual one. A share of stock has a cost of \$100 and a minimum current value of \$50,000. If used as part of a gift proposed by someone in his 70's,

gift tax would be payable on \$50,000, but capital gain to recipient (upon subsequent disposition) would be measured from the cost of \$100 plus the applicable gift tax which in this case was \$10,000. The sum of the gift tax plus potential capital gain tax, in the particular case, would exceed the estate tax if the stock were retained by the donor. Thereafter gain on disposition would be based on value at date of death instead of the \$100 cost plus gift tax.

Get Benefit of Full Disclosure

The undesirability of keeping any secrets from the attorney and the CPA was emphasized earlier. The same is true of the insurance coun-

sellor and trust officer. Don't let the testator be coy and name an executor without telling him about it. Don't ask someone to administer the affairs without advance knowledge of the instrument by which he will be bound or without an opportunity to give of his experience. Many corporate trustees struggle with extremely difficult problems which would not exist had they seen the will prior to the decedent's death. In short, all those who can assist should have adequate opportunity to do so.

Only in this way can "what becomes of what you've got" be legally sound, administratively practical, economically advantageous and humanly desirable.

On "The World's Biggest Balance Sheet"

Perhaps the day is far removed when the total financial picture of the Government of the United States can be summarized in a conventional-appearing balance sheet.

But we need not wait for Government to develop such an accounting. Every one of us has a responsibility to examine the strengths and weaknesses of our governmental system from time to time. Only when we are armed with facts, rather than impressions or illusions, can we express ourselves on the course which we would have our Government follow.

On these two principles—citizen responsibility and a passion for the facts—rests our whole idea of democratic government. We have claimed that this is the best of all systems, but we have never claimed that it is easiest.

And we can learn from history that economic soundness does not guarantee a nation greatness, but that without it no nation can be great. Greatness is our goal. The eyes of the world will chart our progress and judge our endurance. Exuberance alone will not suffice. What is needed is the disposition to conserve our resources, to live within our means, and to cultivate a passion for realism.

MAURICE H. STANS

Ohio Certified Public Accountant

To What Extent Should the Accountant Assume Responsibility for Long-Form Report Data?

Long-Form Audit Report Responsibilities

By Russell V Puzey

Responsibility for supplemental information in a long-form audit report is often assigned to the wrong person by the issuing Certified Public Accountants, by clients and by bankers and other interested third parties. The purpose of this article is to show that if the independent accountant performs his audit in accordance with generally accepted standards, that if his report is prepared in accordance with generally accepted standards of reporting, and that if he properly assigns responsibility for data included in the long-form audit report, he will have every reason to issue the long-form report as the fountainhead of his engagement and of the public accounting profession.

Background

The format of long-form audit reports which will be the basis of the discussion was developed by Mr. A. W. Torbet in 1941. It has since been followed by all offices of the firm of Frazer and Torbet. Basically, the following data are included in the order named:

Our certificate, followed by the three basic financial statements (Balance Sheet, Statements of Income and Retained Earnings) and the Notes to Financial Statements.

A scope section which does not go into complete detail of the scope of engagement but does set forth the general nature of our examination, the extent of certain tests and a disclaimer of responsibility for included data compiled by the client and not subject to regular audit procedures.

Result of operations section which usually includes comparative income statements with supplementary data relative to operations.

Financial data section including comparative balance sheets with a statement of application and source of funds, as well as, financial ratios and other data.

Long-term debt section which sets forth pertinent information relative to long-term debt and shows the computations made under terms of long-term indenture relative to restrictions as to payment of divi-

dends, incurrence of debt, etc. This section also includes a special certification as to compliance of the client with covenants included in the indentures and the fact that no evidences of default are found.

The balance sheet comments section is usually restricted to normal delineation of the items making up the various amounts shown on the balance sheet, plus special data such as aging of inventories and receivables.

The last section includes schedules of income and expenses by classification, plant or company and may include analysis of fixed asset changes, etc.

Authoritative Literature

It appears advisable first to explore the basic problems of the accountant's responsibility and of his possible liability to those who may suffer damages from reliance upon material that appears or does not appear in the long-form audit report. To understand these problems there is need to explore briefly the general nature of the accountant's liability.

Authoritative literature relative to the public accountants' responsibility and liability includes a book entitled *ACCOUNTANTS' LEGAL RESPONSIBILITY* by Saul Levy and articles in the *Journal of Accountancy*, issues of December 1955, March and June of 1956, and April 1958. The American Institute, published in 1953, a booklet entitled "Long-Form Practice." Under date of July 1957, the Committee on Auditing procedure of the American Institute issued Bulletin No. 27 concerning long-form reports. This bulletin will be discussed somewhat during the course of this article.

The following discussion is channeled into three main subjects, as follows: General Nature of responsibility; Bulletin No. 27; and, Specific Areas of Doubt.

General Nature of Responsibility

The general nature of responsibility of a practicing public accountant, for included data to which he certifies, can be segregated into two main categories. The first is the responsibility to the client and the second is responsibility to third parties. The two are considerably different. The relationship with the client is contractual in nature. In other words, there is a contract to perform an audit engagement.

This contract may be written, oral or merely implied through performance of the engagement for a fee. All are about equal in effect. Under that contract certain duties must be performed and the audit must be made in accordance with generally accepted auditing standards unless there are specific understandings to the contrary. Each practicing accountant is familiar with the ten basic auditing and reporting standards, which need not be discussed here. If an audit is conducted in accordance with those standards then the accountant is in a strong position as concerns his contractual relations with the client. The client is in a stronger position to obtain damage than is the third party because of the contractual relationship. This explains why the client is more apt to obtain damages resulting from failure to find defalcations, failure to report gross errors, or failure to call attention to material items affecting the credibility of the financial statements as a whole.

The client usually recovers under gross negligence and does not necessarily have to prove fraud on the part of the accountant. Gross negligence is usually roughly defined as expressing an opinion on the basis of an examination so flimsy that there could not possibly have been an informed opinion. Neither a client nor a third party can recover from the accountant if the failure to disclose a material fact results from honest errors in judgment after the accountant has made a thorough investigation of a particular situation on which that judgment was based.

Finally, the financial statements are the statements of the clients which the accountant believes to be true as a result of his independent examination but not of his own particular knowledge. In other words, the accountant does not create the statements from his knowledge, but does believe they are materially correct from the tests he has made.

Third parties may sue the accountant for fraud when such third parties rely upon certified statements and those statements turn out to be faulty or misleading. Generally, it may be stated that actual fraud must be proved, but very few instances of actual fraud have been sustained. Actual frauds that have been proved have usually been in connection with income tax preparation. However, in the absence of actual fraud the accountant may be found liable for damages to third parties for inferences of fraud. Inferential fraud is charged if the accountant was so negligent in the conduct and extent of his work

and if his departures from normal procedures were so gross as to raise the inference of fraud. In such cases, he can be held liable in the same manner and to the same extent as if actual fraud had been exercised.

Basically, inferential, or constructive, fraud means that the accountant has issued an opinion or a judgment on the basis of an examination so inferior that there could not be any possible basis in fact for that judgment. If the accountant had followed the generally accepted auditing standards and had exercised his judgment on the basis of the work performed under such standards, he could not be held responsible for an honest error in judgment because he would have had a sound basis for his judgment. However, if he refused to see the obvious or investigate the doubtful on items of material consequence such oversights may lead to inference of fraud. Here again, if this happens it would result in a departure from the ten audit standards. It should be emphasized that merely following the standards of auditing procedure is not enough; the accountant must follow the standards of reporting which include the disclosure of all material facts dealing with the credibility of the statements being reported upon.

Finally, under this facet of the responsibility of the accountant, I believe the accountant must not hesitate to accept responsibility; he must not hesitate to insist to the client that his fee will be sufficient to cover the scope of work necessary to conform to accepted auditing standards. Lastly, he must insist upon the reports being

RUSSELL V PUZEY is a partner in the firm of Frazer and Torbet, Chicago, Illinois. This paper is based upon remarks made at the Illinois Society Technical Session in Chicago in April, 1960.

prepared in such a way as to agree with accepted reported principles and standards. Certainly, the client and the public should never have the impression that the profession is trying to dodge responsibility, or that certificates rendered by members of the profession are not based upon sound judgment. The profession must constantly stress that rendered judgments are based on sound and generally accepted standard auditing principles and reporting practices.

Bulletin No. 27

The statements on auditing procedure in Bulletin No. 27, as issued by the American Institute of CPA's, are concerned primarily with two problems. The first of these concerns the responsibility for data included in long-form reports over and above the basic financial statements taken as a whole, and the second deals with the problem of issuance of concurrent long- and short-form reports relative to the same engagement. According to this bulletin many long-form audit reports include the usual short-form type of auditors' opinion specifically covering the current year's basic financial statements, but without specific reference to other data included within the report. As a result no distinction is made between data covered by the auditors' examination and data which may not have been examined by him but which is included in the long-form report. This may lead to an inference that the accountant assumes more responsibility than was his intention for such included data.

Bulletin No. 27 may be quoted directly as follows: "It is the opinion of the committee that, in the absence of a statement by the auditor to the contrary, it may be presumed that

he assumes responsibility for such other data in the long-form report, to the same degree that he does for individual items in the basic financial statements; that is, that they are fairly stated in all material respects in relation to the basic financial statements, taken as a whole." The committee goes on to state generally that the auditor may wish to clarify his position in respect to the foregoing with a brief statement in the comments or in a scope section of the long-form report explaining that his examination was made primarily for the purpose of formulating an opinion on the basic financial statements taken as a whole (Balance Sheet, Income and Retained Earnings Statements, including Notes to Financial Statements) and that the other data included in the report, although not considered necessary for a fair presentation of the financial position and results of operations, are presented primarily for supplementary analysis and historical purposes. He would then state that they have either been subjected to the audit procedures applied in the examination of the basic financial statements and are, in his opinion, fairly stated in all material respects relative to the basic financial statements taken as a whole, or that they have not been subjected to the audit procedures applied in the examination of the basic financial statements, stating the source of information and the extent of his responsibilities assumed, if any, for the various data included. The object here is to maintain a clear-cut distinction between the management's representations and the auditor's representations as to the included data.

When a long-form report is issued concurrent with a short-term report

it is essential to determine whether the long-form report contains data, the omission of which from the basic financial statements would support a contention that the basic financial statements were misleading because of inadequate disclosure of material facts known to the auditor. The auditor must also determine if such data lend themselves to the contention that they constitute exceptions or reservations as distinguished from mere explanations of the basic financial statement items. This particular problem deals primarily with the standards of reporting and not necessarily with the standards of auditing. In other words, if the principles of reporting were followed in the basic financial statements for all material matters, either in statements or as footnotes thereto, there would be little to fear relative to any data included in the long-form report. However, if the data were omitted from the basic financial statements because the accountant's judgment was based on a flimsy examination, and subsequent examination indicated that an exception should have been taken and that exception is included in a concurrent long-form report without recall of the previously issued and concurrent short-form report, then the accountant is in serious trouble. This is true because the long-form report destroys the validity of the opinion rendered on the basic financial statements in the short-form report.

Apparently this all comes back to the basic concept of the auditor's responsibility that if he follows generally accepted standards of auditing performance and reporting requirements he has nothing to fear in his reporting practices so long as the

basic and material items are fully explained in the basic short-form statements. In other words, the reader should have generally the same impression of the financial condition of a company after reading a short-form audit report as he would have after reading a concurrent long-form audit report covering the same basic financial statements.

Another question explored in Bulletin No. 27 concerns whether the long-form audit report taken by itself contains other financial data in such form as to support a contention that the auditor has made factual representations with respect to the financial statements or books of account rather than expressed an opinion on financial data consisting of management representations. Management has the basic responsibility for the financial statements and the auditor's representations are confined to his opinion on such statements. Under this generally accepted and understood concept, the auditor is expressing his professional opinion and is certifying to facts true to his own knowledge. This same basic concept underlies the long-form audit report and draws the attention of each to the need for careful preparation of such reports so that it is made clear that he is expressing therein the same type of professional opinion as he expressed in the short-form audit report. He should not hesitate to assume responsibility when he is qualified, by the scope of his examination, to believe that data is fairly stated in relation to the basic financial statements taken as a whole. On the other hand, he should not hesitate to disclaim responsibility for statistical and other data which are included

at the request of the client but which have not been verified within the scope of the accountant's audit functions. The long-form audit report is a mark of distinction for the profession. It is a challenge to the profession and is a definite asset to the client and to those whom he may furnish copies, provided the report was prepared carefully and is the end result of professional skill and judgment. It is the report of a personal service of a highly technical nature rendered to the client and, therefore, should be made as readable and attractive as possible.

Specific Areas of Doubt

Some of the areas of doubt wherein comments included in the long-form report may reflect upon the materiality and credibility of the basic financial statements can be illustrated as discussed below.

If material items are disclosed in the comments dealing with the matters enumerated below, the accountant's judgment might be severely challenged if they were not also included as part of the basic financial statements. Only balance sheet items are discussed, as the income items would be the subject of another article at least as long as this one.

The following items are certainly always of concern and if material in amount or effect should be disclosed in both long-form and short-form audit reports and if disclosed only in the long-form report and if material, the accountant should be in trouble:

Cash—If restricted or reserved but not segregated.

Securities—Same consideration as for cash. In addition, whether or not

they were pledged and market value in relation to balance sheet value.

Receivables—Pledged or assigned; disclosure of collection failures through aging, large doubtful accounts, comments on reserves or collectibility of specific accounts or over-all, and foreign accounts. The latter is particularly applicable in cases where there are sales in foreign countries undergoing international political upheavals.

Inventories—A whole series of judgments must be exercised relative to inventories including disclosure relative to slow-moving stocks; obsolete stocks; finished or sub-assemblies or unusual accumulation of finished goods; location of inventories consigned or pledged; large orders not delivered; delineation as to finished, in-process and raw stocks; inclusion of overhead and labor or method of computing value and, whether LIFO or FIFO or some other basis is used in pricing.

Fixed property—Adequacy of depreciation, specific condition of property or locations leading to doubtful values.

Deferred charges and credits—Judgments as to the adequacy of insurance coverage, amortization and capitalization and capitalization policies.

Liabilities—Aging of payables; disclosures of large indebtedness to individuals or stockholders; prepayment on orders; status of tax examinations.

Long-term debt—Restrictions relative to dividends, debt and working capital under long-term debt indentures are particularly troublesome as the necessity for disclosing them may depend upon the condition of

the company and the relative nearness of the operation of the restrictions.

Capital—Often there are found restrictions as to ownership or sale of capital shares or restrictions on retained earnings for various reasons. Contingencies—There always are questions arising relative to materially contingent assets or liabilities or commitments not in the ordinary course of business.

With a little reflective thinking relative to each of the above, one can easily imagine a great many instances where data included in a long-form audit report might greatly influence the reader over the information gained from the basic financial statements.

Responsibility for Data Included

The assignment of responsibility for data included in the long-form report is often a problem. A few balance sheet items may be listed to illustrate this problem. The principle involved is that the accountant must take responsibility for those things that the accountant is responsible for or he must disclaim responsibility where the included data are the client's and have not been audited.

Receivables—Aging, number of days sales included, post balance sheet collections.

Inventories—Classifications as to salability or usability, aging, obsolescence allowances, discontinued models, usable work in process.

Detailed fixed property additions.

Detailed schedule of expenses or income by product class, by location or by properties.

Data relative to number of employees, hours worked, number of stockholders, et cetera.

Summary

Public accountants have a welcomed and ever-growing responsibility, a contract with a client, a responsibility to third parties who rely on certified data, and a responsibility to themselves to follow generally accepted standards and to make those standards generally known. We should freely assume the responsibilities that are ours. If we follow generally accepted standards of field work and reporting with a clear delineation of responsibility for included data in our reports we have nothing to fear from long-form audit reports. Finally, let us push the long-form audit report as the icing on the cake for our profession. It serves a real purpose for the client, the credit grantor and any interested third party. It is a wonderful tool to improve and uphold audit standards and reporting principles. Long-form reports are, through their preparation, a most useful and thorough training medium for the advanced staff. Finally, they improve the supervising partners' understanding of the client and are, therefore, often the wellspring for the offering of needed services to the client.

Do not let us, as a profession, become too cost-conscious, too much in a hurry, or delegate our responsibilities so far that we cannot write a long-form report. Rather, let us embrace the idea and build our profession around the basic core of all our worth—*an informed sound judgment of the financial statements and of the company.*



STEERING COMMITTEE FOR THE AICPA ANNUAL MEETING

The Society's Steering Committee for the AICPA 1961 Annual Meeting to be held in Chicago, October 29—November 1, is planning for the most successful meeting in Institute history. The above picture was taken in the Society's offices on December 29, 1960.

Front row (left to right) W. R. Blew, Chairman, Sub-Committee on Printing & Publicity; Mrs. E. Waldo Mauritz, Chairwoman, Ladies Committee; Richard S. Claire, General Chairman; Raymond A. Hoffman, Chairman, Sub-Committee on Social Events Planning.

Back row (left to right) Lawrence J. Seidman, Chairman, Sub-Committee on Registration & Housing; Leo V. Tinkham, Treasurer, and Chairman.

Is Service to Your Profession of Any Value to You?

Perimeters

It is certainly amazing, if not altogether staggering, the amount of knowledge the human mind perceives and judges, retains and discards, in the course of even a relatively quiet working day.

The successful practitioner long ago learned that the seemingly rudimentary ability of how to read must be highly refined and regulated by a skillful awareness of not only what to read but where to read it. This has become a business fact of life.

Proficiency with the tools of one's profession is not enough. Similarly, the old adage, "if you want to get a job done, do it yourself," is not necessarily applicable to all situations of life. There are perimeters. It is true, however, that the self-same perimeter of professional development containing the advancement of a lone individual expands considerably in the presence of a group wholly dedicated to a common cause.

The group satisfies our need for an exchange of ideas. The benefits accruing to its members are often described as intangible. However, the state society member who has selflessly devoted time and energy to his group can certainly measure his efforts in terms of tangible results. So, too, the member of the Institute and so much more so the member of both.

The certified public accountant who extends the perimeter of his profes-

sional usefulness through active and self-sacrificing devotion on the local level is obviously the kind of man equally concerned with the kind of representation his profession enjoys on the national level. He is also the kind of man who appreciates the facilities of a truly large organization and realizes that the progress of any profession is in direct proportion to the contribution of each member of the body. This belief was generously supported in a recent letter from an AICPA member who is also a past president of his state society.

"For many years, I confess, I took only slight interest in AICPA and State Society affairs.

"... About five years ago I was elected president of the State Society. ... After my year as president, I was amazed to find that my practice had suffered not at all—in fact, my gross receipts and net income both rose sharply over the prior year.

"... The AICPA annual meeting was another eye-opener ... the papers which were presented had plenty of meat in them for practitioners in any size office ... the informal exchange of ideas outside of the meetings themselves was even more useful. ... I found that all of us faced similar day-to-day problems—no matter where we practiced or what size our offices were.

"... I have attended every succeeding annual meeting ... reasons may be summarized as follows:

"1. The acknowledged leaders of our profession are invariably in attendance. . . . From these men I can (and do) learn much.

"2. . . . I return full of new ideas and with different perspective.

"3. First-hand knowledge of things to come can be obtained only by such meetings, and permits me to direct my own future accordingly.

"4. When the affairs of my clients require services in other cities, my acquaintance with CPAS in all parts of the country is exceedingly helpful.

" . . . Annual meeting attendance is even more important to local practitioners than it is to CPAs affiliated with large national firms. CPAs in large firms receive many of the benefits I have enumerated from intra-firm meetings and communications. The smaller firm, however, must rely on contact with other firms for a fresh look at itself and its problems."

The American Institute of CPAs is your national professional organization, and enjoys as a whole the private abilities of tens of thousands of its members. Its services range from publications to education, to research, technical services, improvement of standards, rules of professional conduct and ethics, a national public relations program, and more than seventy-five working committees covering every area of influence wherein the rights and duties of the CPA must be maintained, i.e., Relations with the SEC, the ICC, the Bar, Small Business Administration, Federal Taxa-

tion, Cooperation with Bankers, and State Legislation, to name a few.

The Institute works in cooperation with state societies for a stronger and better profession. Its members believe that it has something worthwhile to offer you—the "where to read it" kind of help we discussed earlier. Unfortunately, however, many thousands of words written and spoken in support of professional unity all too often fall upon deaf ears. Perhaps it would be fitting to close with a further excerpt from the letter quoted earlier.

"To give you a graphic picture of what has happened to my practice during the last five years, let me give you a 'before and after' profile—before and after I discovered the elixir of professional awareness, that is.

Gross Income up	170%
Net Income up	110%
Total Staff up from 4 to 16	

"All this occurred during a period in which I spent substantial time in state society activities (as president, director and committee member of several committees) and in AICPA activities (as member of Council, of several committees and of the speakers' bureau). Unfortunately, the greatest effect may not be measured in percentages. That effect is the change in my own mental attitude and outlook. From a condition of relative lethargy, I found myself swept into the mainstream of dynamic changes occurring in our profession. Having sampled the spring tonic of awareness and its exciting effects, I could never be satisfied to go back to my old dull existence."

The foregoing article is based upon a letter received from an AICPA member who is also a past president of his state society. It is particularly interesting because it is true.

One CPA Firm's Experience With Punch Tape Accounting

Experience With Punch Tape Accounting

By Ralph H. Bearden

Our firm, as the result of an article in the May, 1959, JOURNAL OF ACCOUNTANCY, decided to venture into the field of punch tape accounting. We ordered two punch tape accounting machines, delivery of which was promised in July, 1959, but not received until January, 1960. In the interim, a temporary machine was supplied in September of 1959, so that we could start processing work accumulated.

While waiting for the machines, we devised a chart of accounts that included all account titles applicable to our various clients, pre-numbering the accounts therein and coded the data to be processed while awaiting the arrival of the punch tape machines.

After one year of experience in this field, we have decided to abandon punch tape accounting temporarily. This decision does not imply that punch tape accounting has no place in a C.P.A. office, but it is our opinion that at the present time, the detriments outweigh the benefits for the following reasons:

1. *Delay in Processing Tapes.* The service center attempted to schedule

work by individual C.P.A.s and not by C.P.A.s as a class. This resulted in a contract providing for two servicings per month with a set-up charge for additional services. To provide the kind of service to which our clients had been accustomed, the costs appear to be prohibitive. We tried various combinations of bi-monthly schedules and found that no matter what combination was devised, some clients during the month did not meet the deadlines and as much as three weeks elapsed from the time data was given our office until a finished report was delivered to the client. We also found that with utmost cooperation from the client, the fastest we could deliver a report via punch tape machine accounting was a week to ten days. Our clients were most unhappy with the time delay.

2. *Difficulties Encountered in Correcting Mistakes.* We found that frequently two months were necessary to correct the mistakes made in accumulating data for processing. If a wrong code number was used by the client or our staff, it was frequently discovered too late to correct in the next month's accounting run and the error

had to be corrected in the second run following. This caused numerous memoranda type adjustments in the intervening months and wasted a considerable amount of time on the jobs.

3. *Difficulty Encountered at End of Year Closings.* Many of our clients do not provide inventories, accounts receivable or accounts payable immediately upon close of the fiscal year. Frequently, inventories were taken at the date of closing but priced and extended at later dates by the clients' employees when it would least interfere with their regular work. It is not uncommon for a client to fall two or three months behind at the close of his year. If we attempted to catch up on a month by month basis through the punch tape machine, we found it would take six months to catch up a client who had fallen behind three months. The answer to this situation was to process transactions monthly without an opening balance sheet or to catch up the work in one lump, but either solution required spending extra time on the job.

4. *Employee Fatigue.* The punch tape attachment sounds like a machine gun operating in the office. This noise was partially eliminated by putting the machine and operator in a private office to which the door was closed, but the machine noise was responsible for an excessive amount of employee fatigue. We found that the efficiency of a person's work decreased sharply after the first hour of running the machine and after the second hour, efficiency decreased to the point that the work almost had to be entirely redone. It is our opinion that no employee should be scheduled for more than a one to one and one-half hour shift each morning or afternoon.

5. *Employee Antagonism Toward Machine Accounting.* We found that the punch tape machine being new there was a natural antagonism and resentment arising among our employees. This antagonism and resentment, coupled with the difficulties correcting errors, caused the employees to blame human errors on the accounting machine in conference with a client. Such action resulted in certain clients demanding that the machine be taken off from the punch tape machine where their demands were unwarranted.

6. *Clients Not Suited to Punch Tape Machine.* Only certain types of our clients are adaptable to the machine operation, these being the so-called "clean" accounts. It is more difficult to process information from clients whose records are not up to date and fairly accurate and upon which the coding has not been accurately maintained. On our more disorderly clients, machine production would constantly be delayed while the operator attempted to obtain information from the client and turmoil ensued.

7. *Difficulty in Analyzing Certain Accounts.* We have had several occasions to attempt to analyze certain accounts for clients or Internal Revenue Agents and found that the records produced by punch tape accounting showed disbursements or purchases by folio and amount thereof, but there was no ready identification of the folio. When working from handwritten records, the vendor or payee frequently discloses the information desired in analyzing the account in question, but with the punch tape machine, it was necessary to look at the check or voucher to ascertain the needed information. By the time v

tempted to analyze said accounts, his original posting information had been returned to the client's office and was sometimes not available or difficult to recover. I can anticipate greater difficulty will be experienced in attempting to analyze records three or five years old.

8. We were advised that it would be extremely impractical to make one run of data and prepare subsidiary records therefrom. This approach is extremely impractical, as it appears to the writer that the processing center should be able to prepare accounts receivable, accounts payable and/or other records from a single run, depending upon the wishes of the client, without the necessity of an involved set-up. The set-up charges proposed when this was requested from our existing service facilities was prohibitive and discouraged several clients from having records processed in this manner.

The above defects are not insurmountable, but they present problems which ready solutions have not been found at this date. We feel that electronic computers are capable of producing better results than mechan-

ical processing, but at the present time the rental of an electronic computer is too great to be available to a small firm.

It is our recommendation that there is a place for punch tape accounting in the C.P.A. office, but the processing should be done by a service center operated by C.P.As. for C.P.As. It is our suggestion that the Florida Institute of C.P.As. could operate a service center for the processing of members' work on a fee basis whereby the chart of accounts would be standardized, the problems of one C.P.A. could be solved in common with other C.P.As. and personnel be employed with enough accounting background to anticipate the problems of C.P.As.

It has been rumored that the University of Miami is going to conduct a class in electronic computers and it is entirely possible that the F.I.C.P.A. could operate their cooperative service center with the University of Miami using the University students as operating personnel. This matter has not been discussed with the University and the writer is not aware of what reaction the University would have to such a suggestion.

RALPH H. BEARDEN is a partner in the firm of Bearden & Miller, CPAs, in Miami, Florida. This article was originally prepared for circulation to the members of the Florida Institute of CPAs and represents the one-year experience of his firm. Comments from readers with similar or differing experiences are welcome.

Are Good Accountants First of All Good Bookkeepers?

Don't Disparage the Bookkeeper

By Leonore Cann

Have you observed the lack of knowledge prevalent among accountants today concerning effective bookkeeping techniques? I have, and I consider it unfortunate. To some extent this trend is due to the replacement of manual record keeping with more modern mechanical and electronic procedures. The price we pay for this form of progress is the gradual elimination of an important phase of training for our bright young accountants coming into the profession. In too many cases the only experience the young accountant has with the practical problem of bookkeeping is the limited academic knowledge he acquired with practice sets during his school years.

A knowledge of good bookkeeping techniques is important to an accountant regardless of his specialty. An auditor with bookkeeping experience will generally display far more inventiveness and imagination in his approach to an auditing assignment than will an otherwise equally qualified staff man. Many accountants working with income and estate taxes possess an excellent grasp of tax laws and their interpretations, but they are clumsy in their attempts to translate their knowledge into debit and credit terms. As a result the effectiveness of a brilliant piece of research can be lost in programming. Financial planning and budgeting are dependent upon financial records pro-

duced by bookkeepers (be they human or mechanical). Obviously, basic data is incorrectly accumulated and assembled the results can be misleading or incorrect, and decisions based thereon may prove unfortunate.

It is in the management services area, the field of systems planning that the need for bookkeeping experience in addition to theory becomes most apparent. The small business man now turns to his accountant more frequently than ever for assistance in this field. Creativity, imagination and ingenuity are certainly required of the accountant who engages in this field. Generally the management services field attracts the accountant with a flair for detail as opposed to the research minded accountant. (Incidentally, please do not confuse the word "detail" with the word "routine." There is vast difference in the meaning of the two words.)

Bookkeeping experience tends to sharpen an accountant's talent for detail thinking. The importance of this quality is most apparent when it is lacking. I am sure you have encountered so-called "accountants" (usually not C.P.A.s) at various levels in both public and private practice who can discuss accounting in a most effective manner. We are impressed. Not until we get into some of the work, delve into some of the records they have designed or supervised, do we become aware of their inadequacy.

cies. They design forms and write up procedures. Unfortunately, when their plans are put into practice they become unwieldy and often extravagant in application. The client is unhappy, his employees are disgruntled, and the accountant cannot comprehend why no one understands him. Personalities are important in such situations, of course, and other factors are involved, but all too often the problem stems from inadequate experience with actual bookkeeping techniques.

Personally, I should like to see the title of "bookkeeper" regain some status. In the field of private accounting the description of "bookkeeper" used to carry some sense of dignity and importance, and rightly so. The bookkeeper was one who kept the accounts and the books. The clerk and cashier, also processed basic records such as invoices, collections, and arranged payments to creditors. In many instances they carried their duties into the preparation of books of original entry from which the bookkeepers made their entries.

The complexity of modern business and tax requirements has made the talents of the old time bookkeeper inadequate. As a result many bookkeeping functions have been absorbed by the administrative accountant. In the meantime the clerk, aspiring to a higher job classification, now refers to himself as a bookkeeper. The title of "bookkeeper" now has a rather fuzzy meaning. Its former significance has disappeared. In the eternal struggle for prestige and pay check the employee who was formerly classified as a bookkeeper now refers to himself as an accountant. Some accountants accelerate the confusion by

referring disparagingly to bookkeepers as if they were inferior creatures.

In the process of downgrading the title of bookkeeper we also tend to downgrade the sound procedures and techniques he developed. Certainly the quill pen, the eye shade, the high desk, and revolving stool are quaint relics of the past. Now we have wonderful new mechanical and electronic tools to assist us in performing bookkeeping operations. But the theory of double entry bookkeeping has not changed. A basic "T" account can still be most useful in helping us to analyze a complicated transaction. The importance of planning the sequence in which source material is recorded, the wonderful shorthand of an indentation or an underscore properly placed, the effectiveness of a well designed chart of accounts in providing management with analytical information supplementary to the basic records but integrated with them, the importance of handling and directing the flow of paper, the uses of filing techniques, an awareness of how transactions originate, the practical problems encountered in preparing and recording basic data, the ability to transmit instructions effectively to those who carry out the actual workings of a system—all these qualities are enhanced by some practical encounter with actual bookkeeping experience.

It is a function of the accountant to analyze and interpret results from records produced by bookkeepers. He can do this most effectively if he understands how such records were prepared. It therefore behooves a good accountant to know how to be a good bookkeeper.

LEONORE CANN is a sole practitioner in Chicago, and is a member of the local practitioners committee of the Illinois Society.

Check List for an Audit Of an Illinois Municipality

By Donald S. Skinger

Many municipal officials have asked, "What audit procedure should be followed by a certified public accountant when he examines the books and records of an Illinois municipality?" The following check list may be used as an answer, in a general manner, to that question. (This check list may also be found useful in the audit of other taxing bodies.) It should be understood that this check list while intended for use in all sized municipalities (except Chicago) is only a broad guide and is not to be substituted for that most important factor, the judgment of the certified public accountant performing the examination. In certain municipalities it will be found that many sections of the check list may be eliminated, whereas in other municipalities expansion of many sections may be desirable. An examination of the check list as related to your municipality should indicate the extent of testing and sampling necessary to en-

able your auditor to express an opinion as to:

1. The fairness of the financial statements which present:
 - a. The financial position of each fund.
 - b. The results of financial operations for each fund.
2. The propriety of accounting principles followed. The American Institute of Certified Public Accountants has distinguished between auditing standards and auditing procedures. For the information of municipal officials who are called upon to select an auditor, the statement on standards is presented.

General Standards

1. The examination is to be performed by a person or persons having adequate technical training and proficiency as an auditor.

In all matters relating to the assignment an independence in mental attitude is to be maintained by the auditor or the auditors.

Due professional care is to be exercised in the performance of the examination and the preparation of the report.

Standards of Field Work

The work is to be adequately planned and assistants, if any, are to be properly supervised.

There is to be a proper study and evaluation of the existing internal control including a study of the financial organizational structure, as a basis for reliance thereon and for the determination of the resultant extent of the tests to which auditing procedures are to be restricted.

Sufficient competent evidential matter is to be obtained through inspection, observation, inquiries and confirmations to afford a reasonable basis for an opinion regarding the financial statements under examination.

Standards of Reporting

1. The report shall state whether the financial statements are presented in accordance with generally accepted principles of accounting.
2. The report shall state whether such principles have been consistently observed in the current period in relation to the preceding period.
3. Information disclosures in the financial statements are to be regarded as reasonably adequate unless otherwise stated in the report.
4. The report shall either contain an expression of opinion regarding the financial statements, taken as a whole, or an assertion to the effect that an opinion cannot be expressed. When an over-all opinion cannot be expressed, the reasons therefor should be stated. In all cases where an auditor's name is associated with financial statements, the report should contain a clear-cut indication of the character of the auditor's examination, if any, and the degree of responsibility he is taking.

CHECK LIST OF AUDIT PROCEDURES

Assets

1. General

- a. Trace and note the disposition of any assets that may have been scrapped, sold, written off, or otherwise disposed of during the period under review. Verify authority for disposal.
- b. See that cash and other assets are separately accounted for as to the various funds.

2. Cash on hand

- a. Count all cash, including undeposited receipts, petty cash, and other re-

volving funds, in all departments, boards, offices and individuals at the same time to determine that all receipts are accounted for. Securities should be examined at the same time.

- b. Examine all cash advances or other items carried as cash but not represented by cash or current checks. See that these items are cleared during the course of the audit.
- c. Find the reason for holding checks not deposited immediately and see that they are cleared before the audit is completed, or make mention of them in the report.

- d. Parking meter funds on hand should be counted or sealed in bags and delivered for counting to the depository.

3. Petty cash funds

- a. Verify that the petty cash funds have been properly authorized.
- b. See that all such funds are set up as assets. See that all payments from such funds for the period are cleared and charged to the proper accounts.
- c. Determine whether money needed for change or similar purposes should be provided by petty cash funds.
- d. See that such funds are not used to provide for unauthorized advances to employees, or to circumvent normal purchasing procedures.

4. Cash in bank

- a. Obtain direct confirmation of all bank balances and reconcile these balances with the appropriate accounts. It is suggested that when confirmations are prepared no account listings be given to the banks. Situations have occurred where the bank will confirm accounts not recorded on the books.
- b. Determine that all checks outstanding at the beginning of the period under audit have been accounted for.
- c. See that cash receipts are deposited intact up to date the audit is made.
- d. Examine all items returned unpaid by the bank for a period of approximately two weeks after the date of the cash count.
- e. Trace and verify deposits in transit to the bank statements.
- f. See that separate accounts are properly maintained for the various funds.
- g. Examine fidelity bonds of officials and burglary and theft insurance policies.

5. Taxes receivable

- a. Confirm directly with the County Treasurer or inspect his records as to the amount of taxes remitted to

the municipality. This confirmation should show current and back taxes remitted for the year by funds insofar as the County Treasurer record indicates. Further division of funds should be prepared using the County Clerk's spread. *This allocation is essential to any audit inasmuch as it is the only way to determine the status of a fund established by tax levy.*

- b. See that the tax-levy ordinance is properly drawn.
- c. Trace tax collections by funds to the treasurer's record of cash receipts.
- d. Ascertain that taxes receivable are properly carried on the balance sheet.
- e. See that proper allowance is made for past due items.

6. Notes and accounts receivable

- a. Verify in detail, the manner depending upon the nature of the accounts.
- b. See that proper allowance was made for uncollectible accounts.
- c. Direct confirmations should be received from the State of Illinois Municipal Sales Tax and Motor Fuel Tax.

7. Investments

- a. Account for all securities by inspection or confirmation and ascertain ownership. See that unmatured interest coupons are attached or accounted for.
- b. See that all investments are authorized and proper.
- c. See that discounts or premiums accrued interest on bonds purchased have been properly accounted for.
- d. Investigate method of safeguarding the keeping of investments owned.
- e. See that investments purchased or sold at any time during the audit period have been properly accounted for, together with the income thereon.
- f. See that the principal and income have been recorded in the proper fund.

DONALD S. SKINGER is a CPA in private practice in Matteson, Illinois. This paper is the result of several years of interest in the problem of auditing municipalities.

8. Inventories of materials (central stores)
 - a. Observe the taking of inventories.
 - b. Make test counts of material items, test prices, extensions and footings.
 - c. Examine procedures of receiving, safeguarding, and issuing stores.

9. Interfund accounts

- a. Compare balances representing loans to other funds with the records of the other funds.
- b. Examine support and authorization for inter-fund transactions.

10. Prepaid expenses and deferred charges (accrual or modified cash basis of accounting)

- a. Test balances by reference to proper records.

11. Fixed assets

- a. Regardless of whether these items appear in the balance sheet of the municipality, suitable records concerning them should be maintained, and these records and the assets to which they refer should be verified to a reasonable degree.
- b. Vouch the additions to fixed assets during the period to determine whether they were properly included in the accounts and added to the property records. See that the municipality received and recorded deeds to real estate it has purchased or obtained by gift.
- c. See that the disposals of all fixed assets were authorized and properly recorded. Also trace cash collections from such disposals into the record of cash receipts.
- d. See that repairs and replacements are supported by the necessary authorized vouchers and charged to the proper accounts.
- e. Check depreciation (if any) and basis thereof.
- f. Inspect insurance policies for coverage and coinsurance clauses.

Liabilities

Trace and note in the working papers the cancellation, remission, adjustment, or liquidation of any liabilities during the period under review.

12. Accounts or vouchers payable

- a. See that accounts or vouchers payable are recorded as a liability.
- b. Determine that obligations incurred during the period under review are properly recorded in the accounts and are in the proper accounting period.

13. Tax anticipation warrants, notes and contracts payable

- a. See that all obligations of this kind are authorized and are properly set up as liabilities.
- b. See that tax anticipation warrants have been retired solely from applicable tax collections.
- c. Circularize note and/or warrant holders if feasible.

14. Judgments

- a. Obtain a confirmation from the municipal attorney showing all judgment balances.
- b. Determine that all judgments are recorded in the proper fund.

15. Interfund accounts

- a. Compare borrowings from other funds with the records of the lending funds.

16. Deposits

- a. See that deposits for services, performance of contracts, etc. are recorded as liabilities.

17. Accrued expenses

- a. The accuracy of accrued salaries and wages should be verified.
- b. Proper accruals should be set up for income tax withheld, social security or Illinois Municipal Retirement, insurance deductions, etc. Verify the ordinance and provisions in the municipality regarding Social Security or Illinois Municipal Retirement. Watch statutory provisions on Illinois Municipal Retirement on certain population municipalities.

18. Deferred income

- a. Licenses collected in advance should be shown herein.

19. Loans and advances from other governmental units

- a. See that such items are set up as liabilities.

- b. Ascertain if any such items are past due.
 - c. Confirm if feasible.
- 10. Bonds and coupons payable
 - a. Verify from bond records and ordinances establishing the fund.
 - b. See that bonds sold during the year are properly recorded.
 - c. Check amount of bonds and coupons due but unpaid.
 - d. Secure direct confirmation from fiscal or paying agent as to funds in his possession for the payment of unrepresented bonds and coupons.
 - e. Bonds due within one year and any other bonds payable out of the current levy should be segregated from future maturities on the balance sheets.
- 11. Surplus and Surplus Reserves
 - a. See that the surplus or deficit of each fund is separately stated.
 - b. See that suitable reserves are set up for items which are not available to meet appropriations. Some of these items are shown below:
 - 1. Inventories of materials and supplies.
 - 2. Advances to other funds.
 - 3. Encumbrances.
 - 4. Bonds maturing after 1 year.
- 2. General property taxes
 - a. Confirm directly with the County Treasurer or inspect his records as to the amount of taxes remitted.
 - b. Verify amounts credited to the various funds by examination of the County Clerk's extension.
- 3. Receipts collected for other governmental funds or units
 - a. See that collections are properly credited to the fund or unit from which collected.
 - b. Check percentages due on fire licenses, etc.
- 4. Grants and subsidies from other governmental units
 - a. Examine statutes and communications.
 - b. Trace receipts into the treasurer's record of cash receipts.
 - c. See that such funds have been properly used for the purposes for which secured.
 - d. Confirm with the State of Illinois the Municipal Sales Tax receipts and allocations.
- 5. Licenses, fees, permits, etc.
 - a. Obtain a schedule of the rates for all license, permit, inspection, recording, and other fees.
 - b. Test check rates charged against approved schedules.
 - c. Trace collections into the record of cash receipts.
 - d. Compare total of each class with average of past few years.
 - e. Check the percentage of license fees credited to the firemen's pension fund in those municipalities apportioning such a fund.
 - f. Segregate prepaid licenses and exclude from current income.
 - g. Where feasible, test check business licenses with the classified sections in the telephone book.
 - h. Account for 2% fire insurance tax.
 - i. Compare duplicate stubs with cash receipts record.
 - j. Verify miscellaneous fees such as certificates, registrar, plat, warms, extinguishment, estimate of redemption, etc.

Revenues and Receipts

1. General

- a. See that money collected by all departments, boards, commissions, offices, or individuals has been turned over intact and has been credited to the proper funds. In case of required interpretation of laws or ordinances, the municipal attorney should be asked for an opinion.
- b. Test the accuracy of the cash receipts records.
- c. Test cash transactions between funds, between divisions of the municipality, and between the municipality and other governmental units. Reconcile inter-fund balances.
- d. Review the authority for all cancellations, remissions, adjustments, or abatements.

6. Fines, forfeitures, and court fees
 - a. Check the docket or other original court records.
 - (1) For fines and fees collected.
 - (2) For the payment of fines by the serving of jail sentences, etc.
 - (3) For moneys held on deposit for bail, etc.
 - (4) For bail bonds forfeited, verify that these have been collected or are in the process of collection.
 - (5) Examine police magistrate's transmittal notices and trace to cash receipts.
 - b. Check police records.
 - (1) Examine into and report on method of waiving payments.
 - (2) Check copies of traffic tickets and warrants issued with the court dockets to determine whether or not all arrests have been properly recorded. Account for numerical sequence of tickets.
 - (3) Examine method of handling parking violations.
 - (4) Account for all cash in police department (parking ticket violations, cash bond deposits, etc.)
 - c. Trace collections into the record of cash receipts.
 - d. In municipalities operating a firemen's pension fund, be sure that the proper percentage of fines is credited to the pension fund.
7. Rentals of property and equipment
 - a. Check schedules, contracts, leases, etc.
 - b. Trace collections to the record of cash receipts.
 - c. See that a schedule of rents receivable has been set up.
 - d. Verify that contracts and leases were properly authorized and approved.
8. Interest on bank balances
 - a. Check agreements with depositories to see that they conform with federal and state banking laws and council authorization.
 - b. Check calculations of interest and trace to accounting records.
9. Interest on investments
 - a. Determine that interest on any security held during the year has been properly recorded.
 - b. Trace all collections of interest into the record of cash receipts.
 - c. Ascertain if all investments comply with the statutes as to type, etc.
10. Franchise fees
 - a. Examine franchise agreements.
 - b. Compute the portion of receipts due the municipality by examination of reports filed by the utilities.
 - c. Trace receipts into the cash receipts.
 - d. Confirm with utility companies.
11. Special assessments
 - a. Verify current collections by reference to assessment receivable records (original rolls). Confirm if feasible.
 - b. Verify redemptions.
 - (1) Payments of past due items should be checked to delinquent publication notices. Interest and penalties should be checked.
 - (2) Redemptions by council action should be verified by examination of resolutions.
 - c. Foreclosures should be verified by examination of court and/or county treasurer's records showing proceeds of the foreclosure and amounts remitted to municipality.
 - d. In cases where special assessment records are inadequate, it may be necessary to issue a separate report based on a limited examination.
12. Sales of commodities and services
 - a. Verify authorization for sales of commodities and services.
 - b. Test check prices if new materials are resold.
 - c. Trace collections into cash receipts.
 - d. See that details of accounts receivable have been set up. If feasible confirm balances.
13. Sales of investments.
 - a. Verify that sales have been properly authorized.
 - b. If feasible check market to cash receipts.
 - c. See that accrued interest to date of sale has been collected and properly recorded in the proper fund.

- d. Trace all collections from sale of investments into the record of cash receipts, by funds.
 - e. Verify the sale of investments through brokers.
14. Sales of bonds or notes.
 - a. Check records authorizing sales (referendum, ordinances, etc.).
 - b. Check discounts, premiums and accrued interest.
 - c. Check with printer of bonds; obtain affidavit of bonds printed.
 - d. Verify bonds sold and unsold.
 - e. Trace receipts into the record of cash receipts.
 15. Sales of fixed assets.
 - a. Review authority to sell. See that statutory requirements are met.
 - b. Trace collections into the record of cash receipts.
 - c. Verify removal of assets sold from the property records.
 16. Notes payable, tax anticipation, warrants, etc.
 - a. Trace receipts from sales of such obligations, into the record of cash receipts.
 - b. Confirm all outstanding balances.
 17. Give special attention to all general journal entries affecting revenues and expenditures.
- f. Verify inter-fund expenditures; see that all such expenditures are properly authorized, and that charges have been made to the proper accounts.
2. Budget and appropriations
 - a. Determine if the municipality adopted a budget ordinance.
 - b. Check the appropriation ordinance for compliance with the statutes.
 - c. Check budget and/or appropriation authorizations.
 - d. See if charges are made to proper appropriations.
 - e. Note whether budget and appropriations are properly encumbered and see if expenditures plus encumbrances are within appropriations.
 3. Purchases
 - a. Inquire into the procedure for making purchases.
 - b. Check prices paid against contracts and/or bids.
 - c. Test check footings, extensions, and discounts on invoices.
 - d. Test check propriety of prices.
 - e. Note vendors' names and watch for irregularities such as the names of municipal officials and employees.
 - f. Determine whether materials and services have been received.
 - g. See if budgets (or appropriations) were encumbered for obligations outstanding at the end of the year.

Expenditures

1. General
 - a. Determine whether expenditures were properly authorized and incurred and are proper charges to the fund and appropriation to which they have been charged.
 - b. See that expenditures are supported by itemized invoices, vouchers, contracts, receiving records, or other supporting documents approved by the proper official, and that they are so marked that they cannot be used again.
 - c. Note whether disbursements were made by checks, properly signed, against the treasurer.
 - d. Examine the endorsements of checks.
 - e. Test the mathematical accuracy of disbursement records.
4. Payrolls
 - a. Compare salaries and wages with the appropriation ordinance.
 - b. Test accuracy of payroll computations.
 - c. Compare payroll checks to the payroll and examine endorsements.
 - d. Test payroll deductions for retirement, withholding taxes, etc., and see that they are properly accounted for.
 - e. Investigate delivery of payroll checks to employees.
 - f. Check amounts and disposition of unclaimed wages.
5. Payment of bonds and interest
 - a. Determine if proper control is maintained for maturing bonds and coupons.

- b. See that bonds and coupons are cancelled after payment.
 - c. Secure direct confirmation from paying agent as to funds in his possession for payment of unrepresented bonds and coupons.
 - d. Determine if any bonds are registered and see that proper accounting is maintained.
6. Petty cash funds
- a. See that proper vouchers are submitted for all reimbursements to each petty cash fund. Check cancellation to prevent re-use.
 - b. See that vouchers plus cash on hand equals the total of the fund.
7. Construction and improvements
- a. Review proceedings of council and/or board of local improvements. Examine bond ordinances.
 - b. Compare the unit prices with the terms of the contracts.
- c. Examine authority and origin of special assessments.
 - d. See that charges are made to the property records.
 - e. List any items due but unpaid on contracts.
8. Notes and contracts payable, tax anticipation, warrants, etc.
- a. List such obligations due and unpaid.
 - b. See that tax anticipation notes have been retired solely from tax collections applicable to them.
9. Receipts collected for governmental funds or units
- a. Verify amounts and authority for payments made to other governmental units.
 - b. Check percentages due on fines, licenses, etc.
10. Give special attention to all general journal entries affecting revenues and expenditures.

Cheerful friends are assets. Morose, pessimistic, long-faced friends are liabilities. Each of us should strive to become an asset, to avoid becoming a liability. Let us make it our aim to radiate sunshine rather than gloom. It is a tonic to visit certain individuals, depressing to visit others. Naturally, the radiant person attracts, the calamity-howler repels. Study how to become a magnet rather than a repellant.

B. C. FORBES

Burden of Proof

Under Section 534

Section 534¹ provides, in substance, that the burden of proof in accumulated earnings cases before the Tax Court will shift to the Commissioner following submission by the petitioner of a statement of the grounds for the accumulation together with supporting facts. This provision is an exception to the general rule imposing the burden of proof upon the petitioner.² Its origin stems from enactment of the 1954 Code when Congress attempted to correct abuses existing under Section 102 of the 1939 Code.³ To the taxpayer in the shadow of this deliquescent *trou-de-loup*, the burden of proof issue is a matter of substantial significance.

¹ Section 534(a) of the 1954 Code provides: In any proceeding before the Tax Court involving a notice of deficiency based in whole or in part on the allegation that all or any part of the earnings and profits have been permitted to accumulate beyond the reasonable needs of the business, the burden of proof with respect to such allegations shall—(1) if notification has not been sent in accordance with subsection (b), be on the Secretary or his delegate, or (2) if the taxpayer has submitted the statement described in subsection (c) be on the Secretary or his delegate with respect to the grounds set forth in such statement in accordance with the provisions of such subsection.

² See Rule 32, Rules of Practice before the Tax Court of the United States.

³ Section 102 of the 1939 Code was carried over in general form to Sections 531-537 of the 1954 Code.

The Senate Finance Committee Report relating to the unreasonable accumulation of earnings⁴ disclosed that the imposition of the burden of proof on the taxpayer had several undesirable consequences. Litigated cases gave evidence that deficiencies had been asserted in many cases which were not screened or analyzed. Taxpayers had been put to considerable expense and effort in proving the accumulation was for the reasonable needs of the business. Furthermore complaints had been received that the accumulated earnings tax was used to induce settlements on other issues because of the difficult burden of proof aspect. To remedy the situation, Congress incorporated Section 534 in the 1954 Code and subsequently enacted legislation effecting retroactive application of Section 534 to pending proceedings tried on their merits under the 1939 Code subsequent to August 11, 1955.⁵ The treatment accorded Section 534 by the Tax Court in the first seven accumulated earnings cases following its enactment, is considered below.

⁴ S. Rept. 1622 83rd Congress 2nd Session p. 70.

⁵ Public Law 367, 84th Congress 1st Session Section 4.

Pelton Steel Casting Company, 28 TC 153, affirmed 7th Cir., 1958 251 F. 2d 278, certiorari denied, 356 U. S. 958, came to trial December 1 and 2, 1955, several months after the date of passage of the law giving retroactive effect to Section 534 with respect to years covered under the 1939 Code. Cited as authority in five of the six decisions following it, *Pelton* must be regarded as the starting point for an inquiry into the Tax Court treatment of Section 534.

Under the facts in *Pelton*, the taxpayer had enjoyed unusual growth in the steel castings business prior to the fiscal year ended November 30, 1946, the year in which the penalty tax was invoked. Having built a profitable business, its majority shareholder attempted to sell his interest to outsiders but was unsuccessful. One of the minority shareholders, owner of 20% of the outstanding shares, was interested in perpetuating management policies established by himself and to this end, successfully acquired the business from the other two shareholders, owners of 60% and 20% interests, in the year 1946. The transaction as finally consummated was a company financed purchase through bank loans and a secured note. During the year 1946 earnings amounted to \$209,731.58 and upon the advice of financiers handling the sale, no dividends were paid in that year.

When challenged by the Commissioner under Section 102 (a)⁶ the petitioner's argument centered around

the reasonable needs of the business and adequacy of the evidence presented. The position of the Commissioner was that Section 534 did not apply (1) to all accumulated earnings cases, (2) where applicable, the critical factor was *purpose* and (3) when purpose was involved the burden of proof, or risk of nonpersuasion as it existed under prior law, remained unchanged.

In arriving at its decision, the Court was faced (1) with shifting the burden of proof to the Commissioner with respect to the unreasonable accumulation under Section 534 or, (2) with holding the grounds or facts inadequate or recognizing an interdicted purpose other than the unreasonable accumulation of earnings.⁷ In finding for the Commissioner it held:

- (1) The legislative history of Section 102 under the Revenue Act of 1938 indicated the burden of proof should be on the taxpayer.
- (2) The issue of interdicted purpose, critical in this decision, could be established separate and apart from the reasonable needs of the business.
- (3) Under Section 534 (c) the burden of proving only some of the grounds may be shifted to the Commissioner and that for such reasons as failure to state "facts sufficient to show the basis therefore" no shift at all may occur.
- (4) Although the evidence may show a bona fide business need, such need may be accomplished without all or a part of the accumulation of earnings.

The Court, however, did not stop at this point. In the final paragraph of the opinion it stated, that assum-

⁶ Section 102(a) of the 1939 Code provides in part, "There shall be levied . . . upon the net income of every corporation . . . if such corporation . . . is formed or availed of for the purpose of preventing the imposition of surtax upon its shareholders . . . through the medium of permitting earnings or profits to accumulate instead of being divided or distributed, a surtax . . ."

⁷ Section 102 (c) of the 1939 Code provides in part "the fact that the earnings of a corporation are permitted to accumulate beyond the reasonable needs of the business shall be determinative of the purpose to avoid surtax upon shareholders unless the corporation by the clear preponderance of the evidence shall prove to the contrary."

ing *arguendo* that the burden of proof of unreasonable accumulation of earnings was a significant factor, it found the earnings accumulated in 1946 were materially in excess of reasonable needs. By choosing, in effect, to ignore the provision of Section 534 in its decision, the Court had established language which, if adopted, could be used to defeat a multitude of taxpayer cases, directly contrary to the intent of Congress.

On appeal to the Court of Appeals for the Seventh Circuit, 251 F. 2d 278, January 7, 1958, the Court did not discuss the burden of proof issue. After analyzing what was accomplished by the parties, the court concluded, "The record was utterly devoid of countervailing evidences either polliating or eradicating the situation interdicted by § 102 . . ." On appeal to the Supreme Court of the United States, certiorari was denied on May 19, 1958.

In the next accumulated earnings case, decided September 13, 1957, the Tax Court held against the Commissioner. Taxpayer in Breitfeller Sales Incorporated, 28 TC 1164, sold Pontiacs at retail under a General Motors franchise. It had accumulated surplus of almost half a million dollars at the end of 1948, half of which was held in marketable securities unrelated to the business of the corporation. All of its shares were owned by a single shareholder. Although the Commissioner found deficiencies of \$56,832.93 and \$58,577.12 in the calendar years 1947 and 1948 respectively, the Tax Court made the finding that a reasonable requirement of the business then existed for the ac-

cumulation. Working capital requirements existing under the General Motors dealer agreement coupled with possible expansion requirements and establishment of a dealership in an adjoining area were held sufficient to account for the large surplus.

The Court found for the taxpayer on the record as a whole, without determining under Section 534 where the burden of proving business necessity rested. However, the proceeding was litigated on the apparently mutual assumption that a decision on the total issue of reasonable needs would dispose of the matter.

In Kerr-Cochran, 30 TC 69, decided April 17, 1958, taxpayer operated a Chevrolet agency. Its shares were owned principally by Clarence Kerr. In addition to the automobile business, it participated in numerous other business activities including (1) participating in a warehouse venture (2) advancing funds for farm operations (3) loaning funds to the principal shareholder's wife (4) advancing the major portion of funds for the establishment of a distant automobile agency (5) participating in a home development project and (6) participating in oil ventures. It also deposited \$100,000 in connection with the sale of automotive parts to the Chinese National Government. Taxpayer's activities extended considerably beyond the sphere of the usual factory dominated franchise agreement.

In referring to Section 102 (c) the Court, citing *Pelton*, stated that where the earnings of a corporation are permitted to accumulate beyond the reasonable needs of the business (as

C. L. SCHUBER, who is tax attorney with the Natural Gas Pipeline Company of America, Chicago, prepared the comments for this issue.

proved by the Commissioner) it is deemed determinative of purpose to avoid surtax upon shareholders unless the petitioner proves to the contrary by a clear preponderance of the evidence. It is submitted that this is a clear case of unreasonable earnings and appears extremely remote from the interdicted purpose area covered under the unusual facts in *Pelton*.

In October, 1958, the Tax Court decided *F. E. Watkins Motor Company Incorporated*, 31 TC 288. Taxpayer operated a Chevrolet dealership acquired in 1946. From that year until 1950 annual sales increased from \$375,000 to over \$1,423,000. Immediately preceding the years 1951 and 1952, the years in which the Commissioner alleged unreasonable accumulations, evidence showed the taxpayer required twice the 18,000 square feet of floor space it was then using. During the years in question, the taxpayer had plans to acquire property across the alley from its own building and did purchase the property in 1953. Taxpayer recognized competitive conditions would prevail following large sales immediately after World War II, which would require additional funds. Furthermore, General Motors Corporation had indicated taxpayer needed working capital of \$226,754 which was \$11,563 less than the taxpayer then had. In reply to the notice received under Section 534 (c), taxpayer filed a statement consisting of 21 numbered paragraphs and five exhibits setting forth grounds and facts in support of its position that it did not accumulate earnings beyond the reasonable needs of the business. In finding for the taxpayer the Court did not rule on which party had the burden of proof, but found

as ultimate facts that the petitioner did not permit its earnings or profits to accumulate beyond the reasonable needs of the business and that it was not availed of for the interdicted purpose.

In *The Dixie, Inc.*, 31 TC 415, decided November 19, 1958, affd. 277 Fed. 2nd 526 (2nd Circuit), petitioner was engaged in the operation of the premises known as Hotel Dixie, title to which rested with King Hotels. Hyman B. Cantor and his wife were owners of the shares of both King Hotels and The Dixie, Incorporated. Hotel Dixie premises at street level and above constituted a hotel of 620 rooms and the lower level was leased as a bus terminal. Actual management of the hotel was given to Carter Hotels Operating Corporation, also owned by Hyman B. Cantor and his wife. It had leased the premises in a series of leases, the first of which was entered into in 1942. In 1955 taxpayer received notice of a proposed deficiency under Section 102 with respect to the accumulation of \$80,193.14 in the year 1952 and was given time to file a statement pursuant to Section 534 (c) of the 1954 Code.

Petitioner alleged as grounds for the accumulation (1) the need for each hotel in the Carter Hotel chain to contribute to the acquisition of new members (2) the need for surplus due to an economic depression in the hotel industry (3) the need to purchase a competing hotel in the area (4) the need for general renovation (5) the need to adapt the lower level to new use and (6) the need to install air conditioning and television.

In considering these contentions, the Court stated that in order for the statement filed under 534 (c) to

be operative in shifting the burden of proof, it must not only show grounds for the accumulation but must state facts sufficient to show the basis for those grounds. With respect to acquiring new hotels, it was held that no facts were stated showing to what extent new acquisitions would make the operation more profitable, or that efforts were being made to acquire any particular hotel, or that even a plan was considered. It held that the record was devoid of any evidence supporting this ground for accumulation. It likewise held in the case of the economic depression and the acquisition of another hotel, that facts were lacking. In connection with renovation, it was held that taxpayer failed to establish sums intended to be spent. It gave little weight to the statement pertaining to the basement because of lack of definiteness in the testimony. With respect to the air conditioning, evidence showed a material overstatement of cost in the initial allegation. However, the Court was willing to accept as reasonable an accumulation up to \$450,000 for air conditioning and television.

On the record it was found that the accumulation of surplus in the amount of \$708,660.51 for the period from 1942 to 1952 without payment of dividends, as affirmative evidence of the fact petitioner was availed of to avoid the imposition of surtax upon its shareholders.

It is significant that Dixie was decided wholly on the unreasonable accumulation and that such determination constituted interdicted purpose under the law. By resolving the issue in this manner, the Court was able to decide the case without controvert-

ing the intent of Congress in creating 534.

In *I. A. Dress Company, Inc.*, 32 TC 93, decided April 13, 1959, taxpayer was engaged in operating a commercial building under a lease. During the years 1944 to 1947 its working capital increased from \$22,049.30 to \$101,548.91, principally due to an increase in cash and United States securities. In 1949, the year in which the Commissioner acted under Section 102, the sole owner retained its entire earnings of \$25,288.15 after taxes. In its statement submitted under Section 534 (c), the basis claimed for accumulation was (1) the welfare of the corporation would have been jeopardized by distribution of a part or all of its earnings and (2) the continued corporate existence required full retention of earnings. In holding the two reasons inadequate, it was said the first was so nebulous as to have the effect of not stating a ground and the second was not supported by the facts. The burden of proof in this case clearly rested on the taxpayer.

On September 30, 1959, the Tax Court decided *Young Motor Company, Inc.*, 32 TC 1336, reversed and remanded 281 F 2d 488 (CCA-1). The taxpayer, a distributor of Oldsmobiles for General Motors had begun business in 1929 and through the years had accumulated a surplus in excess of \$300,000. The surplus was not in excess of what the company required incident to the purchase of another automobile franchise if General Motors terminated its contract which it had the right to do. Deficiencies were determined in the amounts of \$15,791.88, \$10,605.70 and \$4,960.90 for the calendar years 1950, 1951 and 1952 respectively. Five

years prior to the first year taxpayer was alleged to have had an unreasonable accumulation of earnings, a representative from General Motors had asked that more adequate facilities be provided under the franchise. Subsequently, it threatened cancellation. Although the taxpayer took steps to acquire additional facilities, its plans, although coming close to materializing, did not so materialize prior to the years covered in the deficiencies. Two years after the alleged accumulation taxpayer's franchise was cancelled. Several years later it acquired a franchise from Ford Motor Company, under the terms of which it was required to maintain a working capital of \$400,000.

Under this somewhat typical factual situation, where the automobile dealer must adhere to the rigid requirements of the factory agreement, the Court held that the burden of proving the absence of prohibited activity was on petitioner under *Pelton* and that reasonable needs was a subsidiary matter which need not be considered.

On appeal to the Court of Appeals for the First Circuit (August 16, 1960) the taxpayer, in substance, admitted that it (1) paid no dividends (2) invested assets of the corporation in unrelated securities (3) made personal loans without interest (4) failed to pay a salary to its president and (5) paid unduly low rental for facilities owned by its principal shareholder and leased to the taxpayer. Nevertheless, it contended, such factors must be considered in the light of whether or not the accumulation was beyond the reasonable needs of the business. The Court agreed with the Commissioner that under the circumstances an accumulation in excess

of \$300,000 without payment of a salary to the principal officer prima facie called for an explanation. However, the Court said the taxpayer had one. General Motors had reserved the right to demand the taxpayer make substantial enlargements of its facilities, a very substantial right considering its contract was terminable at will. Also, the taxpayer had asserted it required money for financing purchasers as well as for fluidity in its competitive business. In the light of these facts the Court held no proper appraisal of a taxpayer's purpose can be made without considering all relevant factors and in so doing expressly disapproved *Pelton* to the extent it held to the contrary.

The Court further stated the Tax Court may have been led into error by a misconception of the precise issue. The lower court opinion had referred to preventing the imposition of surtax upon shareholders as "one" of the taxpayer's purposes, and finding it, held it would apply irrespective of other purposes. In holding this construction far too favorable to the government, the Court of Appeals stated the issue to be the primary or dominant purpose which led to the decision to accumulate earnings, citing *Commissioner v. Duberstein*, June 13, 1960, 363 U. S. 278. In that decision the taxpayer had received an expensive automobile as a gratuity for suggesting prospective customers' names and the issue of motive in connection with transfer was before the court. The conclusion of the Supreme Court that the decision of the issue presented in the case "must be based ultimately on the application of the fact finding tribunal's experience with the mainstrings of human conduct to the totality of the

facts in the case" emphasizes the initial importance of the factual situation in every accumulated earnings case.

Perhaps the most disconcerting aspect of the burden of proof problem is the procedural treatment it is accorded in the Tax Court. When the petitioner attempts by motion to ascertain if the burden has been shifted to the Commissioner, the Court has refused to rule. Refusal stems, in part, from the fact that the judge hearing motions may not be the judge who will hear the case. It is said that a decision with respect to the grounds for the accumulation would bind the trial judge. As a result decisions are rendered, as in *Breitfellers and Watkins*, without any ruling designating

which of the litigants has the burden of proof.

Presentation of an extensive factual situation in an accumulated earnings case places an arduous task on the taxpayer, regardless of who has the burden of proof. Congress intended that Section 534 remove some of the inequities which have appeared in this area. Although some Tax Court decisions seem to have circumvented this section, at the present time it must be recognized as having an impact on every taxpayer brought within the purview of the accumulated earnings sections of the Code. For those who may have felt Section 534 had been laid to rest quietly by *Pelton*, a thoughtful reading of the appeal in *Young* is likely to show it has been quietly resurrected.

If We Catch Up With The Soviets

What will Americans have to do to catch up with the Soviet Union?

Bryce N. Harlow, deputy assistant to President Eisenhower, mentioned a few of the things in a speech at the recent Southwest Electric Conference at Chandler, Arizona.

In order to enjoy the glories of the present Soviet system, he said we would have to abandon three-fifths of our steel capacity, two-thirds of our petroleum capacity, 95 per cent of our electric motor output, destroy two of every three of our hydro-electric plants, and get along on a tenth of our present volume of natural gas. We would have to rip up 14 of every 15 miles of our paved highways and two of every three miles of our main-line railroad tracks, and shrink our civilian air fleet to a shadow of its present size. We would cut our living standard by three-fourths, destroy 40 million TV sets, nine of every ten telephones, and seven of every ten houses; and then we would have to put about 60,000,000 of our people back on the farm. In addition, we would have to murder about 25,000,000 of our people and put 15,000,000 more into concentration camps.

It is plain to see that we have a lot of work to do if we are to catch up with the Soviet Union!

—From the Butte, Montana, *Standard-Post*

Ideas for Accountants

LOCATING TRIAL BALANCE ERRORS

Herman Berger has a very handy method of locating trial balance errors which is particularly useful for accounts receivable or accounts payable. We shall discuss his method for accounts receivable.

After usual checks have failed and he sees that he is going to have to check postings, Herman does this: he takes an adding machine and adds all the postings as shown by the folio reference in accounts receivable ledger as being from the cash receivable journal. If the total of this tape equals the total as shown by the accounts receivable journal the postings from the accounts receivable journal have been proven. In running this tape space should be left between each letter and the tape marked for each letter—thus:

A	56.00
45.68	3.50
23.21	2.63
89.67	8.95
23.00	58.90
58.90	619.83S
24.00	
264.46S	C
	52.10
B	32.65
26.34	23.01
59.10	727.69S
52.35	etc.
87.60	

Then if the ledger tape is out of balance with the cash accounts receivable total it is a relatively simple matter to check the journal in detail to the tape by the alphabetical reference.

If the cash receivable tape balances, then apply the same method to the sales journal entries and other journals in turn until the difference is located.

This method will speedily locate posting errors and errors of footing the journal. It will not locate errors in balancing the individual accounts.

This method can also be used for locating general ledger trial balance errors except for the fact that the tape will not be alphabetized.

PROVING AN ADDING MACHINE TOTAL

Frequently there is occasion to add a column of figures and determine if the total so obtained balances with another figure—*e.g.*, the detail list of receivables balances with the control account total, the credits of a trial balance with the previously added total of the debits, or the assets total of a balance sheet with the total already obtained for the credits. Most accountants compare by sight checking the total obtained on their tape with the figure against which they are balancing.

If the adding machine is equipped with a direct subtract key, a better method is to subtract out the figure with which the tape total is to be compared after completing the addition. The tape should then balance at zero. The advantage of this method over sight comparing is that there may be a tendency for the eye to slide over the figures, particularly if they are large. If the previously determined total is subtracted out it must be actually read. If the figures are not read properly the total will not balance at zero.

IDENTIFYING SCHEDULES

It is desirable to number schedules appended to income tax returns for quick reference. Gilbert Rockoff points out that the income tax forms identify the detailed tabulations contained therein as *schedules* and with *letters* (thus dividends on Form 1040 are detailed on "Schedule A"). He suggests that schedules presented on separate sheets of paper included by the accountant be distinguished by the use of the term *exhibit* and *numbers*. Thus a separate dividend tabulation included by the accountant on a separate sheet, rather than on the form itself, might be referred to as "Exhibit 1," a list of contributions as "Exhibit 2," etc.

The "Ideas" for this issue were submitted by HERMAN BERGER of Fields & Fields, Chicago; LEONARD CAMPBELL, and GILBERT ROCKOFF.

AS WE GO TO PRESS

"RULE 13"

Probably no other single item engendered as much interest at the annual meeting of the AICPA last September as did the motion to delete the present Rule 13 of the rules of professional conduct and substitute therefor a new Rule 13. Since the annual meeting Rule 13 has been the subject of considerable discussion in the **Journal of Accountancy** and in professional publications of a substantial number of state societies. All indications are that the revised Rule 13 will be submitted to the annual meeting of the Institute in Chicago in October. If favorable action is taken at that time the revised rule would be submitted to the membership of the Institute for mail ballot. We in the Illinois Society who have lived with a rule substantially the same as the proposed Rule 13 and who have found it both workable and sound have a unique opportunity to convince those who doubt the wisdom of the revision that the profession as a whole will benefit from its approval.

ARE YOU A MEMBER?

A recent study by the AICPA showed that of 69,232 CPAs in the United States 37,379, or 54.0% were Institute members and 45,342, or 65.5% were members of their respective state societies. The data disclosed that Illinois CPAs are below these averages for membership in professional societies. Of 5,171 CPAs in Illinois 2,548 (49.3%) are Institute members, while 2,970 (57.4%) are members of the Illinois Society. Are you a member? How about your associates?

TRENDS AND TECHNIQUES

The latest edition of the AICPA survey of corporate financial reporting practices, covering 1959 annual reports, continues to provide a wealth of reporting information. Extended use of comparative statements, increased use of five or ten year financial summaries, elimination of penny columns (and even dollars to the thousands), greater disclosure of long-term lease details and of stock option plans, and a trend toward more meaningful terminology are only some of the trends revealed in this latest study. The study is filled with examples of disclosure of unusual accounting and reporting situations.

ACCOUNTING IN THE NEWS

The February issue of Changing Times, the Kiplinger magazine, includes an article titled "Careers in Accounting," in which accounting is described as a field with spectacular yet solid growth. The article is aimed mainly at high school and college students and their parents and is one of a series providing basic information on the characteristics of various professions.

WILL WE SEE YOU IN SPRINGFIELD ON MAY 4-6?

CLASSIFIED ADVERTISING

THE ILLINOIS CERTIFIED PUBLIC ACCOUNTANT accepts classified advertising at the following rates:

20 cents per word, minimum of \$3 per ad. Box number counts as two words. Advance payment required.

A box number, if desired, will be charged for as two words.

The closing date will be the 10th of February, May, August, and November. Address all replies to the office of the Illinois Society of Certified Public Accountants, 208 South La Salle Street, Chicago 4, Illinois, to the box number given in the ad.

WANTED: CPA or Attorney as co-tenant or sub-tenant in 2 or 3 office suite (not yet acquired). My girl can answer phone. STate 2-6781.

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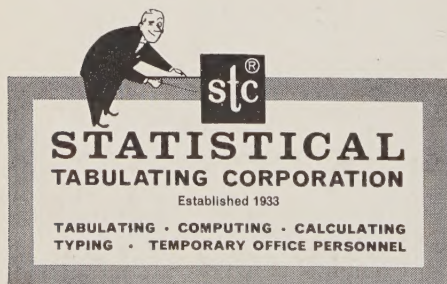
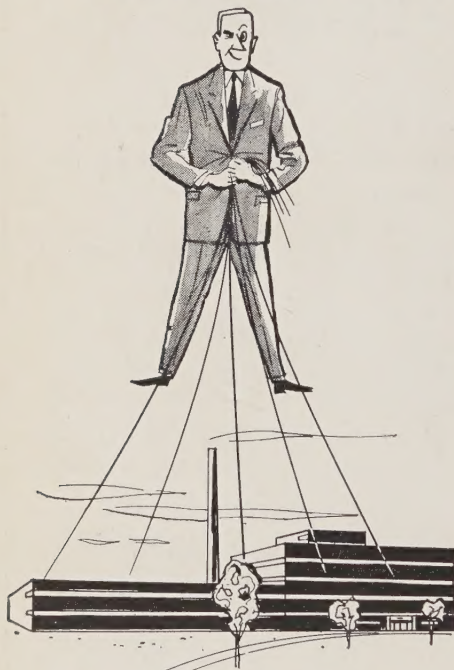
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